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20 Victoria Street
Toronto, Ontario M5C 2N8
Tel.: (416) 362-5211
Toll Free: 1-800-387-2689
Fax: (416) 362-6161
Email: info@micromedia.on.ca

Assessing the Economic Feasibility of Private Single Room Occupancy Development in Ontario

Final Report

Submitted to:
Ministry of Municipal Affairs and Housing

Submitted by:
Steve Pomeroy, Focus Consulting Inc.

In association with
Will Dunning,
N. Barry Lyon Consultants Limited

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Introduction and Objective

The Ministry of Municipal Affairs and Housing commissioned this research to explore the economic feasibility of privately developed Single Room Occupancy (SRO) Accommodations in Ontario.

Traditionally, SRO accommodation has been located in older former residential hotels, usually in inner city locations. These properties have provided very minimal accommodation - essentially a private room, with or without a private bathroom and kitchenette. This housing form serves very low-income individuals, usually males. The clients can include persons with various disabilities (including substance abuse, psychological problems, and physical impairments), but may also include working people, whose ability to pay for housing is constrained by low income, or who may have a lifestyle preference for modest housing.

While very modest in quality and level of amenity, these SRO premises have played an important role in addressing the housing needs of low-income singles. As such they have helped to reduce homelessness. However, the supply of this type of accommodation has not kept pace with rising needs, and the supply, in fact, appears to be diminishing.

Over the past decade the concept of constructing new SRO accommodation as an additional supply of modest, affordable housing has emerged in a number of US cities, and the concept is attracting interest in Canada.

These new SRO housing projects are often marketed to a narrow client group of low and moderate wage working singles, and can exclude non-employable individuals who are considered higher risk and and/or more demanding as tenants.

Singles represent a significant number of households - in Ontario there are over 520,000 one-person renter households. These represent 38% of all renters. Of these 70% (364,000) are non elderly (Statistics Canada 1998). Moreover the growth rate for single person households is higher than any other household type (Lewis 1997).

A substantial number of singles have low income and require affordably priced housing. In 1995, some 220,000 singles in Ontario earned less than $15,000 and as such could not afford to pay more than $375 for rent (based on a 30% affordability standard). By comparison, there were only 131,000 units renting for less than $400 in 1996 - indicating that there is a shortfall of almost 100,000 low rent units. This shortfall suggests that there would be a strong demand for accommodations renting below $400 per month.[1]

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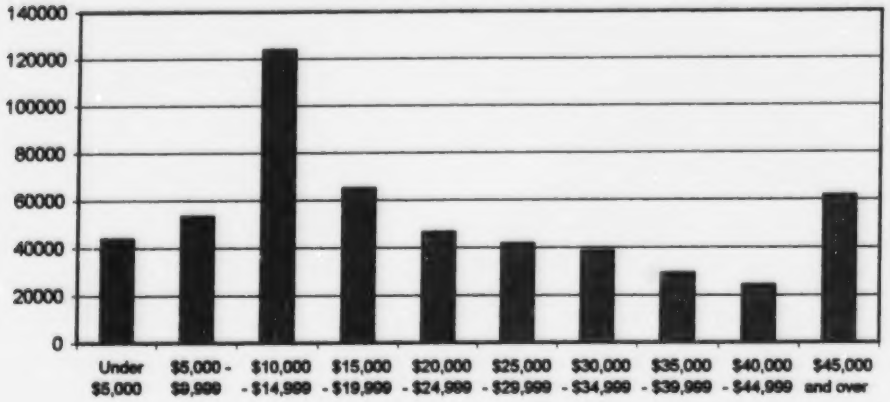
1 In addition, there were a total of 285,000 singles with incomes below $20,000, implying an affordability limit of $500 - meanwhile in 1996 there were only 212,000 units with rents below this limit.

Income Distribution of Single Person Households (Ontario 1995)



Source: Statistics Canada Electronic Census Products, 1998

The central objective of this research project was to determine whether it is possible to produce SRO accommodation within an affordable rent range, beginning at the $325 welfare minimum for singles and up to the affordable market range of $500. The research method was to:

- Identify appropriate housing forms, through literature reviews and through contact with housing providers
- Develop financial simulations for various housing forms. By estimating costs and revenues, profitability (the rate of return on equity) is calculated, and conclusions can be drawn on whether such development would be sufficiently attractive to investors and developers.
- Further analysis considers alternative parameters on the cost and revenue side, including higher rents (of up to $500 per month) as well as some measures that might be taken by government bodies to reduce or offset costs.
- Following the financial analysis, conclusions are drawn on the conditions that might encourage private sector development of SRO accommodations.

Framed in this way, the focus is not directly on responding to homelessness, because:

- The housing that results will not necessarily be targeted to the hard-to-house.
- The housing may not necessarily be affordable to individuals on welfare.

However, if a significant supply of such affordable SRO accommodation were available, the risk of homelessness will be reduced.[2]

[2] In addition to addressing affordability problems of singles, provision of affordable small suite/SRO type units may help ease pressure on two and three bedroom stock suitable for families - some of this family stock is currently occupied by 2 or three singles sharing a dwelling to minimize their costs.

The recent work of the Toronto Mayor's Action Task Force on Homelessness has scoped the nature of the homeless and at risk problem. The chronic homeless - individuals that suffer from some form of mental or physical disability or from substance addiction are a very small proportion of the total "at risk" population. The chronic homeless number less than 5,000 in Toronto (Task Force Interim Report). There are a much larger number of people who do not suffer from serious illness or addiction - they do however experience a problem of poverty and housing affordability. These households, many of whom are singles, number over 100,000.

This is a critical distinction. The (5,000) chronic homeless individuals require much more supportive environments and few private SRO operators would be prepared to serve them, and usually only if adequate supports were funded. Thus, the chronic homeless population is likely to remain within the realm of not-for-profit supportive housing providers.[3] This report will direct some discussion to the chronic homeless sub-population, but in the main, the focus is on providing affordable housing for individuals who do not require supportive services.

Defining an SRO

In order that readers have a clear understanding of how the term SRO is used in this report, it is appropriate to provide some definition at this early juncture. SRO accommodation encompasses a wide range of building forms and unit arrangements. The term has been used generically to refer to residential hotels, multi unit apartments with small-scale "efficiency" units, lodging houses, rooming houses and boarding houses. SRO accommodation should be understood to cover a range of attributes and design features. The *unifying element is that SROs are positioned at the lower end of the housing spectrum*, in terms of modest cost, small dwelling sizes, and limited amenities.

Affordability is maximized when facilities like bathrooms and kitchenettes are shared. However, marketability and livability are enhanced when these features are included within the private unit. Thus, in projects targeted to very low-income households, and especially where subsidies are non-existent or very limited, some sharing is likely. In developments targeting low-to-modest income working singles, a higher level of private amenity (rather than shared facilities) is more characteristic. In either case, the units are smaller than conventional studio or bachelor apartments.

These housing forms are not currently permitted in most jurisdictions, unless special regulatory measures have been enacted specifically to authorize them.

For the purpose of this report, we will adopt the following definition:

SRO accommodations provide private rooms of less than 300 sq. feet in a multi unit property. Private units might have partial kitchens, and full kitchens might be provided on a shared (common) basis. Full bathrooms are provided on either a private or shared basis. Common social areas and communal dining might be provided within the building but are not a prerequisite.

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[3] This is not to say that private operators will not entertain an arrangement where specialized community support services are contracted and separately funded for residents in a private SRO - this practice is already in place, with organizations like Habitat services providing such support.

Structure of the report

Following this introduction, this report is presented in four sections.

Part 1 provides a general introduction to the concept of SRO's and the recent trends, essentially over the last decade, toward the development and rehabilitation of this building form. Examples of built projects from other jurisdictions, both in the US and in Canada, are briefly reviewed. This review includes consideration of design and management issues, as these impact directly on the examples that will be analyzed in subsequent sections.

Part 2 reviews and dissects the design and building specifications to identify some prototypes to be explored. These prototypes draw from the experience and lessons in other jurisdictions. A project proforma is developed for each prototype, exploring development costs and financial viability.

In Part 3, we report on the results of a stakeholder consultation. The sample designs and proformas were presented to a range of experts including developers, regulatory and zoning officials, lenders, and operators to identify issues and constraints that might inhibit the development of the SRO accommodation. This is our reality check, providing insights on the real viability and feasibility of this type of development in Toronto.

The report concludes in Part 4 with a summary of findings and recommendations.

Part 1: Review of recent private SRO development

SROs stock in decline

The Single Room Occupancy building form is largely a legacy from the first half of the twentieth century. As part of the process of industrialization and urbanization, the housing form that we now commonly refer to as SRO's proliferated in response to the need for accommodation by individuals, usually males moving to cities to work in new industries. These new residents had limited need or ability to pay for elaborate living spaces - they simply sought a room and a bed at an affordable price. Lodging houses and residential hotels were very common and readily accepted.

In the post war period of rapid suburbanization, the SRO dwelling form began to fall into disrepute (Frank 1991, Olds 1991). Regulatory change and minimum property standards in many North American cities classified SRO's as substandard accommodations and lenders became increasingly reluctant to finance new investments, or to provide refinancing for upgrading and repair. Physical deterioration followed, in concert with inner city deterioration that was stimulated by the suburban exodus (Frank 1991, p 248)

Urban renewal (beginning in the late 1960's), the expansion of central business districts, and, more recently, revitalization of inner city areas as tourist destinations, have together contributed to the dramatic displacement of the older SRO stock (NAHB 1991). It is estimated, for example, that since 1970, the city of New York lost 110,000 SRO units, some 87% of the entire stock. (Frank 1991) Similarly in Toronto, the SRO stock has been in decline (Mayor's Task Force Interim Report 1998) while Vancouver has lost over 4,000 units since 1970 (City of Vancouver 1998).

Although often in substandard condition, the SRO stock was nevertheless an important source of relatively cheap accommodation, particularly for single males. In response to the erosion of this stock, a number of major US cities developed policies in the late 1970's and early 1980's to prevent further demolition or conversion of SRO stock (e.g. San Francisco, San Diego, Portland, New York).

These policies concurrently sought to encourage the rehabilitation of existing SRO's. Portland was a pioneer in convincing the US Congress and the US Department of Housing and Urban Development (HUD) to extend eligibility for federal rehabilitation assistance to the SRO stock (through a Section 8 Moderate Rehabilitation Demonstration Initiative). Subsequently, the Stewart McKinney Homeless Act (1987) provided significant funding for SRO rehabilitation and many cities have allocated federal block grant funds to help finance SRO rehabilitation and preservation.

Although gentrification redevelopment displaced existing SRO's, many cities adopted bylaws with a requirement that the units be replaced. This prompted a number of cities to explore options for developing new SRO accommodations.

Targeting SRO's to a new market niche

The late 1980's consequently saw a divergence in approaches. Many cities sought to preserve, rehabilitate, and build new SRO properties, in order to meet the needs of a largely marginalized singles population (including those with various degrees of mental illness and substance abuse). Others focused on a new niche - the lower income (minimum wage) workers in the expanding service sector. This population does not require high levels of support and counseling - they simply require affordable housing, something that had become increasingly out of reach as real estate markets boomed in the 1980's.

Stimulated by a housing affordability crisis that was associated with high migration and a real estate boom, and faced with serious growth in the visible homeless population, a number of California cities became pioneers in this endeavor. San Diego emerged as the national leader, enacting new building regulations (as a demonstration initiative) to encourage SRO development. The industry responded and over 1000 units were constructed between 1987-89. A further 1000 units followed in 1989-91. However, since then, new SRO development has virtually ceased, primarily because regulations imposed new parking requirements that undermined the viability of this building form. These were imposed when a developer sought to build a SRO in an area outside of the downtown core, adjacent to residential zones - local residents forced the parking amendment.

Market based projects, targeted to low wage working individuals have spread from San Diego to other cities including Palo Alto, Las Vegas, and Phoenix. These projects are relatively unique, targeting the independent low wage worker who does not require a supportive housing environment. (In other cities, most of the SRO development has tended to serve the traditional homeless - the chronically unemployed and those unable to work).

Focus is on lower cost building forms

In the US southwest, a fairly standard model has evolved for privately owned and operated SRO's. This typically involves four-storey wood frame construction, with some commercial space on the ground floor. Underground parking is based on a bylaw requirement of 0.2 spaces per unit (although this can be lowered by provision of bicycle lockers and "in lieu of" fees). The properties provide 150-200 private rooms, ranging in size from 125 to 220 square feet and renting for $325-$630 per month. Some units receive city rent subsidies lowering rents to $200-$265.

Following the lead from the U.S. there has been similar interest in Canada in adopting lower cost building forms. Through the mid 1980s and early 1990's a number of projects with smaller scale "efficiency units" were developed under social housing programs. These typically involve self-contained units built to a minimal suite size under the prevailing code allowance (generally 275 to 300 sq. ft). Notably, there is one very recent example of a market rent SRO developed in Vancouver. Although not developed under a social

housing program, this project benefits from some public assistance in the form of leased land and below market interest rates (through a provincial government interest reduction program).

A number of proposals are under consideration or progressing toward development in Victoria, and in Toronto.

Brief profiles of small suite and SRO developments in the US and Canada are presented in Appendix A.

Lessons from Recent US experience

SROs are not unsubsidized

Although often cited as private unsubsidized developments all SRO projects in the US have been assisted, usually through tax incentives and below market interest rates. For example, the US subsidy system uses tax benefits to attract equity investment (often covering one third of the capital cost); tax exempt bond issues attract below market interest rate financing. [4] A portion of the units in the projects (usually 20%) are then required to be targeted to low income individuals (e.g. incomes below 40% of the area median). The remaining units in the privately operated projects carry rents of $350-$600, even with this favourable equity and financing.

The fact that significant levels of public assistance are available to fund SRO initiatives in the US is an important underpinning of the private investment. This public financing lowers the investor's equity, debt costs and limits the risk. With reduced debt to finance, and low debt service costs, the return on equity is enhanced, to levels that are acceptable to investors (and that reflect the risk of this somewhat non-conventional product).

Niche market

The private operators of these projects are targeting tenants who, while low income, are quite capable of living independently. Thus no supportive services are provided on site, nor is amenity space set aside for supportive services.

Developers have experimented with various unit sizes. Some early projects provided only 80 sq. feet, but these are without private bathrooms. While very small individual units may improve the economics of development, since the rent per square foot tends too be quite high, these smaller sizes can be more difficult to market or keep filled. These small units without private kitchenette or bathroom are more characteristic of the traditional SRO. Those targeting the low wage working singles tend to provide "self contained" features.

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[4] While not subsidized in the traditional form of ongoing subsidy payments, these financing vehicles impose tax revenue losses on government and are in effect a form of public assistance.

More recent examples, such as a project just started in Las Vegas, have adopted a minimum unit size of 150 square feet. In Vancouver BC, the community in the downtown Eastside, which has actively worked to preserve and enhance the SRO stock, rallied strongly against a proposal to develop units of only 120 square feet.

Diligent management

A key characteristic is very careful management, including heavy screening of applicants. Housekeeping services are provided, in part as a service, but also as part of a management plan - this ensures access to and monitoring of the individual units on a weekly basis. Swift action is taken against any residents abusing the unit. A 24-hour staffed front desk and security systems are also seen as mandatory. This security is an important marketing feature, especially where single women are an important part of the potential market.

In the lower income SRO's the management model also encompasses a form of "probationary tenure". New tenants are initially on a day to day rental - at a higher daily cost than long term tenancies. If the tenant complies with house rules and is well behaved, they may graduate to a weekly tenancy with a drop in daily costs, and eventually onto a monthly tenancy with a further reduction. In short, the tenant must prove him/herself as a good tenant. Those initially on the day-to-day tenancy are removed immediately if they "break the rules".

High quality design and upkeep is seen as a key to maintaining occupancy by "better tenants". These features also support a rent tier above very low income affordable levels (i.e. $400-$600 versus $300). This extra $100 or so tends to act as a deterrent to very low income unemployed singles.

Tradeoff between capital costs versus operating expenses

On paper, small very modest units may work, but a San Diego effort to address the needs of the hard-to-house proved unsuccessful. The objective was to target the very poor - those able to pay only $200/month (compared with the $350-$600 in market SRO's). Units were only 120 square feet, with very modest construction. The small low cost units tended to attract transient "hard-to-house" and low income, unemployed tenants. Poor management compounded the natural attraction of the property to lower income, more transient individuals. Without a management system to identify and remove problem tenants, and to carefully monitor who entered the property, the building soon fell into disrepair and began to experience high vacancy loss, causing viability problems.

The key lesson is that while capital costs might be minimized, higher operating costs in the form of a very structured and proactive property management system is imperative - this is labour intensive and impacts project viability.

Large properties

One consequence of high security and 24-hour staffing is that it is difficult to achieve financial viability without large-scale developments. Almost all of the properties reviewed are at least 150 units, with some exceeding 250 units.

Minimal parking

Project economics are precarious at best, and this is impacted by the expense of constructing parking (especially underground). Viable projects have been built with very little parking - premised on the fact that lower income tenants cannot afford cars. Moreover, the projects are located adjacent to the downtown area and on public transit routes. In San Diego, for example, a 300-room project provides only 39 parking spaces, while a 192 unit development has only 20. Requiring parking will negate project feasibility.

Building Efficiency Is A Challenge

The non-profit developed small suite projects in Vancouver have tended to have a poor construction efficiency ratio - with net-to-gross ratios of less than 70%.[5] The designs that have evolved in San Diego seem to have honed in on more efficient design - wood-frame construction of a four-storey building with an interior courtyard. This design permits double loaded corridors and improves light access.

Climate is a Factor

Almost all of the US experience has been in the south, where the climate facilitates greater use of outdoor amenities and reduces the need for indoor amenity space (either in-suite or in common areas). It also permits building design with high levels of light access, open balconies and roof terraces. This helps to compensate for small unit sizes. The harsher climate in Canada suggests that individuals will spend more time in their rooms and accordingly more space may be appropriate, implying either larger suites or more common space. This also implies more difficulty in minimizing the amount of construction required.

Design Options and Building Considerations

In order to assess the economic feasibility of private SRO development we first generate some prototype designs, based on the recent experience with market rate private SRO's, as well as projects developed as supportive housing.

A number of proponents have undertaken design studies that augment the information obtained from the preceding review. These include focus groups with potential residents, to ascertain key design priorities. The Cool Aid Society in Victoria assembled a mock-up suite and consulted street youth on its features. The City of Vancouver, in collaboration with the Downtown East Side Residents Association, similarly used displays of four prototypes (ranging from 145 sq. ft to 340 sq. ft) to test receptivity to small suites (City of

[5] Design analysis in the current study has similarly encountered difficulty in achieving net-gross efficiencies much greater than 65%

Vancouver 1998). Vancouver City also commissioned a micro suite design study that explored alternate mini-suite sizes in different building configurations (Jansen 1996). Finally a very detailed analysis was undertaken by a supportive housing organization in New York.

The New York study developed a design manual with detailed floor plans and building specifications to enable development of a prototype 40 to 50 unit single room occupancy community residence. Specifically intended to serve individuals with psychiatric disabilities, including homeless individuals and individuals being discharged from institutions, the prototype includes a higher level of common and amenity space than might be necessary in a private market project for individuals who do not need supportive features. Nonetheless, the detailed analysis carefully considered such issues as appropriate room size, security, and technical aspects of the building system.

Building Features

Exhibit 1.1. replicates the design recommendations developed by an environmental psychologist based on a stakeholder/resident consultation (NYSOMH 1993). Although prepared in the context of supportive housing, many features of these guidelines are relevant to independent living units. The primary exceptions relate to service delivery areas, such as office space intended for counseling and some of the common space. In general, a single social lounge (which could be achieved through a large lobby with seating areas) and, possibly a recreation room/gymnasium, may suffice. In addition, in the case of supportive housing, proponents favour smaller projects (40-60 units). In contrast, the new private market rental SRO's in the US south west have tended to be quite large, generally in the region of 200 units or more.

A fairly high level of security features, notably including 24 hour staffing of a front desk is evident in these New York guidelines. The imperative for these security features will be a function of location, but they are advisable in transitional inner city locations. Although the target market may not be individuals with supportive needs, the lower rents are likely to attract an array of lower income individuals, including those with some history of mild or episodic illness, and possibly former substance addicts. Compounded by location, such individuals will be at risk of victimization by drug dealers and others. Appropriate screening and monitoring practices should be in place to ensure that illicit activities do not migrate into the building. As noted earlier, securing buildings (possibly with staff monitoring who is entering) may also be an important feature in marketing the properties, particularly to single women.

Unit Features

The use of built-in furnishings is another common feature of both supportive housing and market rent SRO's. The limited floor area in each unit dictates very careful use of space - this can be achieved effectively through careful customization and standardization of furnishings (finished cabinetry). Also, units are typically provided with mini fridge,

microwave and cable TV, all of which have some implications for construction costs.

Exhibit 1.1

SUMMARY OF DESIGN RECOMMENDATIONS
for a supportive single room occupancy community residence
Source: Richard Olsen (1993)

FOR THE APARTMENTS
Each unit should have:
- an adequate size
- a layout that provides for some separation between the sleeping and cooking areas
- a private bath with:
- linen storage shelf and medicine chest
- toilet that will flush waste down effectively and not clog (tank sufficiently sized or powerful enough water pressure)
- window or ventilating fan
- adequate storage facilities (i.e.-drawers and closet spaces)
- an individual kitchenette that is visually distinct from the sleeping area and which includes:
- a refrigerator adequately sized for storing and freezing one-two weeks worth of food
- a conventional oven or a large toaster oven-broiler, or convection oven that can be placed on a shelf
- three burners (that change color when they are on so residents will not burn'-themselves or their food.)
- a pull-out work surface/cutting board
  storage cabinets for utensils, cooking implements, food and cleaning supplies
- a smoke detector that is not directly above the cooking area or which is specifically designed for kitchens

- furnishings that include:
  - a captain's bed
  - a comfortable chair
  - a small dining table and chairs (preferably with a fold down leaf for company).
  - a five drawer dresser
  - a night stand
  - storage or display shelves
  - a small desk if spatially feasible

FOR THE FACILITY
- Several community rooms-including a large one for television and adjacent ones for music and games. These rooms should be located on the ground level.
- A small lounge per floor, for visiting, smoking, small group meetings, etc.
- Outdoor space protected from the street -Ping pong, pool and game tables -Stereo-tape deck, wide screen television, and a VCR
- A laundry room, with a clothes folding table, located adjacent or close to the main television lounge

(Olsen Design Recommendations cont'd)

- vending machines for soda and snacks
- office space for staff, including private interview rooms for staff -resident counseling
- off-season storage in the basement for residents (individual lockers or bins for security)
- separate facility storage for food, cleaning agents and paper goods
- janitor's closet or "slop sink" per floor

TECHNICAL FEATURES

- individual temperature controls in the units
- air conditioning and/or more powerful-ceiling fans
- wiring for individual telephones (or more pay phones on the resident floors)
- wiring for cable
- adequate sound insulation between the units
- an effective and high profile security system
- buzzer and security guard at the front door, intercom to front door and to the individual rooms to announce visitors
- (decorative) bars and gates on the ground floor windows, tamper proof locks on the apartment doors, cameras and audible alarms on all outside doors.
- emergency cords or intercoms in the units
- overhead lighting on dimmers in the apartments

DECOR CONSIDERATIONS

- a variety of soft colors in the public space -variation in colors in the rooms
- -variety-of texture and furniture styles -color coordinated flooring -ethnically sensitive and appropriate artwork
- plants
- varietv in window treatments

The precise size of each unit and the liveability of that unit are significantly impacted by the interior layout of each unit. Various focus groups and post occupancy evaluations have emphasized the need to provide a minimum net living area before considering bathrooms and kitchenette. Both NYSOMH (1993) and Jansen (1996) have identified 110-120 square feet as a minimum net floor area to accommodate basic furnishings and permit mobility.

In addition, it has been suggested that the quality of this space is enhanced when the sleeping and dining areas are distinct, so that the occupant is not eating in the sleeping area, the bed is not visible from the door, and the kitchenette is shielded from the bed. Similarly, a separate enclosure should be provided to accommodate the bathroom. Jansen (1996) suggests that a minimum net area of 35-40 square feet is required for a bathroom and a further 35-50 square feet for a complete kitchenette. In total this yields a minimum net area of 175-210 square feet.[6]

Exhibit 1.2 illustrates two sample room layouts encompassing 150 and 250 square feet respectively. The smaller type "A" unit reflects a configuration at the end of a corridor - with a door in the long side of the unit which serves to create a more useable space as the entry hall doubles as a separation space between sleeping and kitchenette/bathroom. In the type A layout the bathroom occupies 40 square feet; the kitchenette area 30 square feet; while the sleeping area total 80 square feet, including the bed, chair, table and wardrobe. Despite a seemingly efficient layout, the Olsen study (1993) determined that most existing residents found this space too cramped.

Unit type "B" (Exhibit 2.2) is perceived as more liveable, separating the sleeping and other functional areas and providing handicap access. The location of the dining area maximizes the use of the "hallway" between the door and sleeping area, and the net floor area for the living space approximates 115 square feet excluding the closet.

A number of new SRO units have been developed below the 175 square foot minimum that is suggested here - some are below 100 square feet - but these generally exclude private bathroom or kitchenette. In the most recent market SRO development under construction in Las Vegas, the smallest unit is 150 square feet. However, not all units in the project are built at the minimum size, there is generally a range of unit sizes. This typically reflects site and building design constraint, which dictate adjustments to optimize use of the floor space.

Toward an optimal design configuration

The site features, location, adjoining uses, and zoning all impact the actual configuration of the building, mix of alternate unit sizes, and typical floors. However, Jansen (1996) has

[6] Consultation with existing SRO operators in Ontario suggests that these ideal unit dimensions may be unnecessarily generous. They note that in most cases single males do not want to cook - they may reheat some fast food, or more often go to a shelter of soup kitchen to eat for minimal or no cost. So private kitchenette and the associated space (35-50 sq. ft) may not be required in properties designed for this target group.

observed that small SRO type units tend to be much less efficient than traditional apartments - a finding we have confirmed in our own analysis. While it is possible to significantly downsize the interior space of the units, there is less ability to reduce the area consumed by hallways. Thus, in a traditional apartment structure, net liveable area might represent about 85% of the total (gross) floor area in the building. In a SRO, it is more likely that the net living area within units will account for only 60% to 70% of the gross floor area.

A deep and narrow unit provides greatest efficiency in maximizing the net-to-gross floor area efficiency in an apartment building (although this may not generate the most liveable floor plan). For example a standard apartment might have a depth of 26 feet, within which a bathroom kitchen/living area and bedroom are strung out. The typical SRO tends to have much less depth - typically 12-16 feet (net), so the same length of hallway serves a much smaller net residential area.

The key elements of an optimal design appear to be:

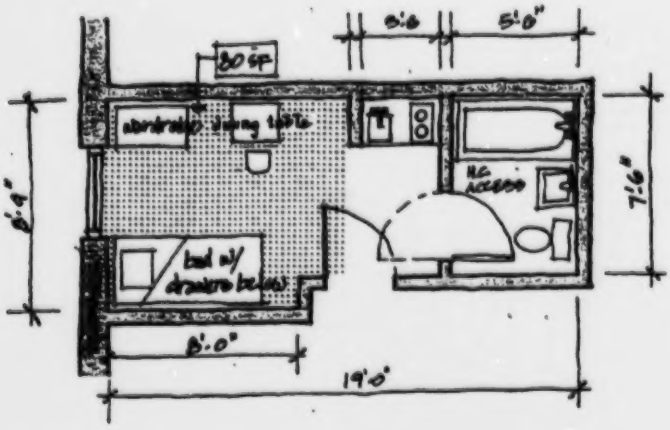
- The small units cannot have much depth or width.
- Each unit needs to have a window.
- Economic realities tend to dictate that a private market SRO's needs to have at least 100 units and typically over 200.
- Low-rise construction may be preferable to generate more affordable wood-frame costs.

The result is that a SRO project might have 30 or more small units per floor (15 or more on each side of a corridor). If configured linearly, the result would be a very eccentric rectangle, of say, 175 feet (or more) by 40 feet. This is unlikely to be efficient from a construction or site utilization perspective. To configure a floor plan optimizing net-to-gross efficiency typically requires the use of interior courtyard or sideyards to facilitate double-loaded corridors, windows and adequate natural light.

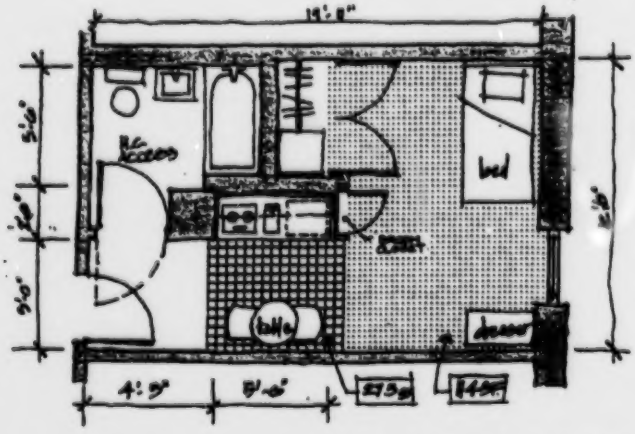
As suggested in the brief review in Appendix A, experience in the US southwest seems to have optimized efficiencies in the form of four storey wood frame buildings with an interior courtyard. A number of the San Diego properties also benefit from large sites with a corner location.

In the Vancouver BC Micro Suite Study, Dane Jansen experimented with both "U" and "T" shaped configurations, concluding (on a hypothetical 120'x 100' downtown site) that the "U" configuration was slightly (2%) more efficient than the "T" in terms of yielding rentable square feet. Adjoining uses will also impact tradeoffs - light wells on adjacent building might be more compatible with a "T" configuration.

Exhibit 1.2



Sample Room Plan Type A 150 sq. ft. (from New York State Office of Mental Health, 1993)



Sample Room Plan Type B 250 sq. ft. (from New York State Office of Mental Health, 1993)

The Victoria Cool Aid proposal is being constructed on a relatively narrow 60'x120' site with a four storey wood-frame building. The ground floor will be used to house the administrative offices of the sponsoring society, with the 2nd to 4th floors providing a total of 40 small suites (180 square feet plus loft area for storage or bed of some 60 square feet)[7], plus 6 one-bedroom units. This particular lot and room configuration allows greater efficiency. After allowing for setbacks, the upper floors of the building have a width of 41', which accommodates a double loaded corridor of 5' width and suites with outside depth of 18' - but even here the net efficiency on the residential floors is only 71%.

Depending on location, and the fact that many SRO's are located in downtown commercial districts, the ground floor may not be appropriate for residential use. Where the property provides supportive housing, it is typical to locate communal space, such as industrial kitchen, dining rooms, social space and administrative/meeting space, on the ground floor. In the market SRO's, especially those in commercial districts, commercial uses often occupy much of the ground floor - a number of the San Diego SRO's have restaurants at the street level. In areas where ground floor commercial is a viable option this can be an important source of revenue to cross subsidize the residential component. However, there is risk that commercial space could be non-rentable at the required rent.

The critical lesson from this experience and design exploration is that SRO developments tend to have a less efficient net/gross floor area than that achieved in conventional apartment developments. Typically in standard multi-family projects a developer will seek to achieve 80-85% net/gross efficiency (i.e. rentable floor area as a proportion of total gross floor area). In a range of prototypes with varying suite size (120 square feet to 245 square feet), lot size (75' and 100' wide) and allocating most of the ground floor to administrative and communal space, Jansen has found that the net efficiency is in the range of only 60%. In our own design analysis for this study, we similarly achieved net efficiencies ranging from 58% to 65%.

Careful architectural programming and the specific features on particular sites may offer opportunities to improve building efficiency, but in general achieving net efficiency close to the 85% industry norms (for conventional multifamily development) is clearly a challenge. We have identified a number of proposed developments that achieve better efficiencies.

One of these is the 30 St Lawrence project currently being developed by Dixon Hall in Toronto. This project involves construction of 10 two-storey row units, with each unit providing private bedrooms and shared kitchen and common areas. In this case the shared unit totals some 1,500 square feet, or an average of 375 square feet per occupant. Technically, the efficiency is 100% (because circulation space is contained within the liveable area of the townhouses), but the actual space required per resident is far higher than in the SRO model. The total costs per resident are no better than in the SRO model (except that the building form - two-storey wood-frame - may provide opportunities to reduce costs).

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7 In order to accommodate this loft design, the floor to ceiling span is 12 feet.

The other project is a 2-storey property, with approximately 45 units on a 9,000 square feet site). The design involves exterior stairs to access each unit. With this design the net efficiency reaches 87%. This model creates building and operating efficiencies. However, in this configuration, securing and limiting access to the property becomes more problematic, and this exterior stair concept may often be unacceptable from a property management perspective.

A third variant is one modeled on student dormitories. Like 30 St Lawrence, these involve shared units, typically with 5-6 individuals sharing a common kitchen living area and bathrooms, but having a private room. Recent projects at small community colleges have involved two storey buildings with 4 units (each with 6 occupants) on each floor for a total of 48 residents. The net efficiencies are similar to 30 St Lawrence since only a common lobby and stairwell are outside the units.

Part 2: Prototype Design Options - for Costing Analysis

From the discussion in Part 1, it is clear that there are a wide range of design options. It is also apparent that there are two potential market segments for which SRO's might be developed:

- Low-wage working singles - both younger singles at the beginning of their working life in entry positions as well as more mature singles working in the service industry, for modest wages (for illustrative purposes below we label this niche "market SRO").
- The traditional rooming house client - former or at-risk homeless, able to live independently with minimal support. The support could be provided through a community based agency. These clients are on welfare, or in casual marginal employment (this market segment is labeled "traditional SRO").

While the terms of reference for the study emphasized the first group, we include options for this second category to illustrate the viability and feasibility of serving this group.

Exhibit 2.1 summarizes the main design parameters that have a bearing on the property configuration and costing exercise. Each of the design options is self-explanatory and might be altered, depending on both the characteristics of the particular site and the target market. The inclusion of private bathrooms and kitchenette is likely to be desirable for the market segment. However, based on the perspective of existing operators and in the interests of minimizing cost, private bathrooms and kitchens may not be necessary in a property targeted to the more traditional population.

Exhibit 2.1 Basic Design and Operating Parameters

Property size	ranging from small community scale 40 units to very large residential hotel of 300 plus units			
Construction Form	wood-frame basic	wood-frame with sprinklering	non-combustible masonry	
Vertical Access	walk-up	elevatored		
Unit Features	bedroom only	with private bath	with private kitchenette	
Unit Size	size is a function of features and ranges from 120 to 250 sq. ft.			
Security level	multi-entry	Single entry	daytime staffing	24 hr staffing
Mix of uses	Residential only	ground floor commercial/community service		

With a view to testing the viability of the SRO model, we have identified two base cases, each focused on one of the identified sub-market groups - market and traditional. In order to develop sample proformas two sites have been identified

Site 1 is large property located in a downtown area: 100 x200 feet, totalling 20,944 square feet. The current zoning would permit a floor space ratio of 5.0 and the ground floor may be either commercial or residential - for the initial illustration it was assumed to be residential and amenity space. The site is a corner property, offering opportunities to maximize rooms with windows along the property line on two sides.

Site 2 is a smaller site measuring approximately 100 x 109 (total 10,822). The site is adjoined on three sides with streets. With the fronting street being commercial, the ground floor space is zoned for commercial use. However, to simplify this initial base case we have excluded the commercial area from the proforma calculations. Some mechanical and amenity space is also provided on the ground floor here, with residential units on 3 floors above. Due to the grade change along the site, the ground floor is technically a basement, for code and zoning purposes.

For each of these sites floor plans have been developed with the objective of optimizing unit configuration and layout based on critical building code requirements - particularly fire access and egress. A variation in unit sizes was used. Three alternate self-contained units were programmed at 175, 210 and 250 square feet. In addition a configuration with a smaller 120 square foot unit with kitchenettes replaced by a shared cooking and dining was developed for one of the sites. As noted in Part 1, we incurred the same difficulties as other SRO developments in achieving net to gross efficiencies ranging from 58 to 65 per cent only. The schematics of alternate floor plans are presented in appendix B.

Two base case configurations are summarized in Exhibit 2.2. One of these is targeted as a market SRO - for the low-wage working singles, without supportive housing needs. This uses a standard 210 sq. foot unit with private bath and kitchenette. The second site explores the feasibility of providing new SRO accommodation for the more traditional at risk clientele, many of which currently live in rooming house stock.

In order to maximize the potential of Site 1 we have assumed masonry construction of a six-storey building. There are 25 units on the ground floor and 35 units on each of the five floors above, for a total of 200 units. Although some modeling was undertaken at 175 square feet, 210 square feet is considered minimal for a unit including private bath and kitchenette, so this size is used in the base case.

Site two is smaller and could permit wood-frame construction without sprinklering. However, for the traditional SRO target market, we have again assumed masonry construction. This is considered a necessary safety feature given the prevalence of smoking and the risk of fires in rooming houses. The sloping site permits a partial basement and 3 storeys above (technically a 3 storey building but with 4 floors). No elevator is provided. Rooms are without kitchenettes, but a communal kitchen with a small dining area is provided for each 12 units. A total of 25 rooms are provided on each floor.

Exhibit 2.2 Base case building configurations		
	Market SRO	Traditional SRO
Property size	20,944 sq. ft.	10,822 sq. ft
Total units	200	75
Construction Form	non-combustible masonry	non-combustible masonry
Vertical Access	6 storey elevatored	3/4 storey walk-up
Unit Features	bath and kitchen	private bath only
Unit Size	210 sq. ft	120 sq. ft
Security level	Secured single entry with front desk and night security	
Mix of uses	Residential only	Residential only

The schematic floor plans for the two properties are presented in appendix B.

Here we first review the base case for the market targeted SRO, and subsequently return to review the alternative that might be targeted to the more traditional SRO population.

Developing Cost Estimates - Market SRO Option

Assumptions

As indicated in Exhibit 2.2 this property involves a six-storey masonry structure with typical units of 210 sq. ft. One elevator is provided (although two might be preferable). With the assumed target market of low wage singles able to live independently, each unit was designed to include a kitchenette and private bathroom. Initially we used a target monthly rent of $325, however this provided to be unrealistic in terms of feasibility and was much lower that the level recommended by current operators - accordingly the base case is generated based on a rent of $425). A scenario showing the impact of the lower $325 rent is however included.

- There are no requirements for specialized amenities or staffing for supportive living functions. Common space includes a lobby/sitting area, small exercise room and storage lockers.

- Minimal parking of 10 surface spaces is provided, although bylaws require substantially more parking (117 spaces).

- Financing is based on standard CMHC underwriting criteria providing a loan at 85% of lending value (as distinct from cost). Mortgage financing is at 6%, with a 25 year amortization period.

- In this base case analysis, it is assumed that realty tax is based on the multi-residential tax rate (4.65%). Later analysis considers taxation at the residential/farm rate (1.26%, which applies to owner occupied condominium structures. The provisions of the new Fair Municipal Finance Act permit municipalities to establish a separate temporary tax class for

new rental construction, which could effectively emulate the condo tax rate (for eight years), without entailing formal strata titling. (Toronto is the only municipality to date to adopt such a bylaw).

- Construction hard costs (labour and materials) are based on prevailing industry levels in Toronto of $65 per square foot for basic wood-frame construction and $75 for masonry. In each case additional allowances have been provided for surface parking, elevators, and a construction cost contingency of 5%. These are reflected in the blended construction cost in the later exhibits.

- Soft costs cover professional services (including legal, planning, and architectural), building permits, development management, interest and taxes while under construction. These are estimated at about 16% of hard construction costs. We have assumed that all municipal fees and levies, other than building permit fees are waived. The City of Toronto is currently considering the implementation of a uniform development charge, which industry participants expect would be $3,500 per unit. Given the results presented here, this clearly would have a very significant detrimental impact on potential SRO development.

- An additional soft cost is GST, which is payable when the building is put-in-use. This is shown as a separate line item in the proforma analysis.

- Land cost is estimated at $15 per buildable square foot. This is premised on an urban location that is relatively central, but would be considered marginal for more conventional residential uses (such as apartment condominiums or up-scale rentals). This land cost reflects a larger site (at least one acre). A SRO would normally be constructed on a smaller site, of one quarter to one-half acre, for which the per unit land cost would be higher. To benefit from lower land costs, it may be necessary to subdivide a larger parcel (with another use, such as modest conventional apartments or commercial or institutional uses on the remainder).

- Operating costs cover staffing and expenses for core property management functions such as rent collection, and property administration, janitorial, maintenance and utilities but excludes property taxes). Private market operating costs would be in the range of $4.00 per year per square feet of net liveable area. With building efficiency at about 85%, there would be a relatively small amount of common areas (hallways and amenity areas) that must be heated, lit, cleaned, and maintained. On a gross footage basis, costs would be about $3.40 per square foot.

  For the SRO, we have assumed equivalent $4.00 of net area, but added an allowance of $55,000 to cover front desk, night security and weekly room cleaning - a typical feature in SRO's (Maid service is a minor component, at an estimated $16,000 per year for a 200 unit project). This generates a net operating expense of approximately $5.30 per net square foot.

The Base Case Proforma

Exhibit 2.3 presents a summary of the proforma for the base case market prototype. It should be stressed that this base case includes a major concession, requiring only a very minimal number of parking spaces (essentially enough to accommodate staff parking).

The proforma shows the total cost of the 200 unit development together with the per unit cost at $37,381. The "bottom line" for this base case is an initial rate of return of 4.9% on the equity invested (cash on cash). With modest inflation in rents of 2% annually, the return reaches only 6.5% after 5 years. As indicated above, we initially tested the base case at a target rent of only $325, reflecting welfare rent levels, however, with this lower revenue the return is even lower, at only 2%, clearly unviable (this is illustrated in exhibit 2.4).

The return on equity of 4.9% compares poorly with a required return in the range of 10% to 15%. As such, this proposed development is unlikely to appeal to investor/developers. Moreover, the equity requirement, estimated at about $13,000 per unit, or 34% of the project's cost would also be a significant impediment.

The level of required investor equity indicated in the proforma is driven by the net income of the project, in combination with a capitalization rate used by lenders and CMHC to determine lending value. Here the net income is premised on the monthly rent of $425. Although the actual cost is $7.5 million, the assessed value, based on a capitalization rate of 9.0% is estimated at only $5.8 million (net operating income of $520,708/0.09).

SRO Proforma Exhibit 2.3 Market SRO

200 units at 210 sq. ft (Private Bath & Kitchenette)

(Site 100'x 209' = 20944 sq ft) **Property Tax Class:** **Multi-Residential Rental**

6 Storey Elevatored Apartment (Masonry) Net-Gross Efficiency 65%

PROJECT DEVELOPMENT COSTS

	Project	Per Unit
Land	986,580	4,933
Construction	5,178,000	25,890
Soft Costs	822,442	4,112
Sub Total	6,987,022	34,935
GST	489,092	2,445
Total Costs	7,476,113	37,381

PROJECT FINANCING

	Project	Per Unit
Equity	2,558,320	12,792
Financing	4,917,793	24,589
		0
Total Costs	7,476,113	37,381
Mtg Ins Fee	245,890	1,229
Total Financing	5,163,683	25,818

ANNUAL REVENUES, COSTS AND CASH FLOW (Yr 1)

		Project	Per Unit	
Revenues:	Rental Income	1,020,000	5,100	
	Other Income	0	0	
	Vacancy Allowance (5%)	-51,000	-255	
	Gross Income	969,000	4,845	
Operating Costs:	Maintenance and Operations	168,000	840	
	Staffing/Maid Service	55,000	275	
	Property Taxes	225,293	1,126	
	Total Operating Costs	448,293	2,241	
	Net Operating Income	520,708	2,604	
Mortgage Payments:	Principal	92,931	465	
	Interest	303,520	1,518	
	Total	396,451	1,982	
	Debt Coverage Ratio	1.31		*Yr 5*
	Cash Flow	124,256	621	167180
	Return (Cash on Cash)	4.9%		6.5%

The maximum, loan is at 85% of this value is only $4.9 million, thus the developer must inject equity totalling $2.6 million (34% of the actual cost). [8]

A number of refinements to the base case were then used to examine ways to improve the economic viability of this development. These involved the following adjustments

- Property taxes based on the lower residential rate (which is applied to condominiums and under recent legislative change, could be the basis for a lower tax rate for new rental/SRO development);
- Reduce unit size to 175 sq. ft thereby adding additional revenue generating units;
- Increase net efficiency, which similarly adds additional units and revenue;
- Utilize lower cost wood-frame construction (this implies reduced density as the building code restricts the number of storeys for wood-frame construction);
- Provide land at no cost or with deferred payment;
- Reduce the level of investor equity, which in the base case is prohibitively high;
- Select a high end location - which may attract a more upscale clientele and support higher rents (approximating $500);
- Substitute commercial floor area - in downtown locations zoning typically requires commercial use on the ground floor. This generates better revenues that residential use and can enhance project economics.

Exhibit 2.4 summarizes the impact of each of these adjustments and includes the result of a rental scenario based on the $325 welfare rent level - a scenario that generates an unacceptable 2% rate of return. The exhibit presents each of the adjustments on a stand-alone basis except the property tax reduction. The upper section of the table uses the current multi-residential rate across all options; in the lower block of the exhibit the lower residential (condo) rate is used in combination with each of the other refinements. The exhibit identifies a number of key variables for the project. In all cases, changes in lending values and equity requirements are critical in determining returns on investor equity. In almost all cases, the analysis shows a rate of return well below the target rate (10% to 15%), assuming realty taxation in the multi-residential class. (The only exception is where land is provided for free). With residential (condo) taxation, rates of return are generally within the target range. Each of the simulations is discussed below.

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8 Any high ratio financing will require mortgage insurance - and for most rental development lenders seek insurance as a matter of policy. In recent years CMHC has used a capitalization rate of 9%, although reflecting a decline in market capitalization rates in the stronger property market that have emerged in the latter 1990's a cap rate of 8% is becoming more standard - at least on sound proposals with reputable developers. Given the untested nature of SRO development CMHC is likely to apply a higher cap rate, so we have retained 9% here.

Lower Property Tax Rate

The obvious first improvement is to assess taxes at the lower residential/farm rate, which increases the rate of return from 4.9% to 11.8%. Not only does this improve the annual cash flow, but also the reduced level of taxation has a critical impact on the lending value of the project. The lower tax cost improves the net operating income, which is the basis for determining the level of financing that the project can support - and the consequent equity investment required to make up the difference between the amount financed and the total cost. At the lower tax rate the level of investor equity ($1.3 million) is almost half that required in the base case and accounts for only 18% of project cost compared with 34% in the base case.

With taxation at the residential rate, the return on equity is with the 10% to 15% target range, at which some investors may consider investment.

Reduced unit size (175 square feet)

In this scenario, there is enough net operating income, even at the multi-residential rate, that minimal equity is required (slightly more than 15%). The rate of return, at 13.6% is within the target range. This is primarily due the additional revenues generated by the extra 40 units that can be accommodated with the reduced unit size. Meanwhile because the total area of the building has not changed, total construction and operating costs remain unchanged - although the cost per unit drops to $31,200

At the residential tax rate, in theory, no equity is required (the building could be financed to 100% of costs). Obviously, some equity would be required. Assuming that the project was financed to about 85% of cost, the return on equity would be 30%.

While this appears to be a viable option, at either tax rate, the units are at the low end of the marketable size range, and there will be some uncertainty about the ability to consistently attract a rent of $425.

Exhibit 2.4 Options to Enhance Project Feasibility

Part 1: Assuming Realty Taxation at the Multi-Residential Rate

	Base Case	Lower Rent (welfare rate)	Reduce unit to 175 sq. ft	Increase net efficiency	Wood-frame Construction (4 storey only)	Free Land	Reduce Equity	High End Location	Add Commercial
Total Units	200	200	**240**	**210**	**130**	200	200	200	**175**
Rent (Monthly)	$425	**$325**	$425	$425	$425	$425	$425	**$500**	$425
Commercial Rent ($/Ft)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	**$12**
Unit Size	210	210	175	210	210	210	210	210	210
Blended Construction Cost (elev & parking)	$80	$80	$80	$80	**$70**	$80	$80	**$90**	$80
Net/Gross Efficiency	65%	65%	65%	**68%**	63%	65%	65%	65%	62%
Total Construction Cost	$5,178,000	$5,178,000	$5,178,000	$5,178,000	$3,023,400	$5,178,000	$5,178,000	$5,858,400	$5,453,625
Total Soft Cost	$822,442	$822,442	$842,884	$827,552	$496,061	$822,442	$822,442	$918,497	$839,614
Land Cost ($/Buildable Ft)	$972,000	$972,000	$972,000	$972,000	$648,000	$972,000	$972,000	$1,620,000	$972,000
Total Project cost	$7,476,113	$7,476,113	$7,497,986	$7,481,582	$4,469,584	$7,476,113	$7,476,113	$9,010,681	$7,789,406
Cost/Unit	$37,381	$37,381	$31,242	$35,627	$34,381	$37,381	$37,381	$45,053	$44,511
Net Operating Income	$520,708	$345,718	$669,449	$549,493	$319,210	$520,708	$520,708	$651,950	$508,594
Lending Value	$5,785,639	$3,841,306	$7,438,322	$6,105,476	$3,546,776	$5,785,639	$5,785,639	$7,243,889	$5,651,045
Maximum Loan @85%	$4,917,793	$3,265,110	$6,322,574	$5,189,655	$3,014,760	$4,917,793	$6,354,696	$6,157,306	$4,803,388
Investor Equity Required	$2,558,320	$4,211,004	$1,175,412	$2,291,927	$1,454,824	**$1,586,320**	**$1,121,417**	$2,853,375	$2,986,018
Equity as % Cost	34%	56%	16%	31%	33%	34%	15%	32%	38%
Cash Flow Year 1	$124,256	$82,499	$159,751	$131,126	$76,173	$124,256	$8,420	$155,575	$121,366
Cash on Cash Return Year 1	4.9%	2.0%	13.6%	5.7%	5.2%	7.8%	0.8%	5%	4.1%

Exhibit 2.4 (cont'd)

Part 2 Assuming Realty Taxation at the Residential (Condominium) Rate

	New Base Case (lower tax rate)	Lower Rent	Reduce unit to 175 sq. ft	Increase net efficiency	Wood-frame Construction (4 storey)	Free Land	Reduce Equity	High End Location	Add Commercial
Total Units	200	200	240	210	130	200	200	200	175
Rent (Monthly)	$425	325	$425	$425	$425	$425	$425	$500	$425
Commercial Rent ($/Ft)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	$12
Unit Size	210	210	175	210	210	210	210	210	210
Blended Construction Cost (elev & parking)	$80	$80	$80	$80	$70	$80	$80	$90	$80
Net/Gross Efficiency	65%	65%	65%	68%	63%	65%	65%	65%	62%
Total Construction Cost	$5,178,000	$5,178,000	$5,178,000	$5,178,000	$3,023,400	$5,178,000	$5,178,000	$5,858,400	$5,453,625
Total Soft Cost	$822,442	$822,442	$842,884	$827,552	$496,061	$822,442	$822,442	$918,497	$839,614
Land Cost ($/Buildable Ft)	$972,000	$972,000	$972,000	$972,000	$648,000	$972,000	$972,000	$1,620,000	$972,000
Total Project cost	$7,476,113	$7,476,113	$7,497,986	$7,481,582	$4,469,584	$7,476,113	$7,476,113	$9,010,681	$7,789,406
Cost/Unit	$37,381	$37,381	$31,242	$35,627	$34,381	$37,381	$37,381	$45,053	$44,511
Net Operating Income	$651,801	$423,801	$845,325	$691,782	$409,333	$651,801	$651,801	$803,465	$607,578
Lending Value	$7,242,233	$4,708,900	$9,392,504	$7,686,467	$4,548,147	$7,242,233	$7,242,233	$8,927,394	$6,750,872
Maximum Loan @85%	$6,155,898	$4,002,565	$7,983,629	$6,533,497	$3,865,925	$6,155,898	$6,354,696	$7,588,285	$5,738,241
Investor Equity Required	$1,320,215	$3,473,549	$0	$948,084	$603,659	$348,215	$1,121,417	$1,422,396	$2,051,165
Equity as % Cost	18%	46%	0%	13%	14%	18%	15%	16%	26%
Cash Flow Year 1	$155,539	$101,132	$240,870	$165,080	$97,679	$155,539	$139,513	$191,731	$144,987
Cash on Cash Return Year 1	11.8%	2.9%	n/a	17.4%	16.2%	44.7%	12.4%	13.5%	7.1%

Although the earlier discussion suggested that 175 square feet might be too small, the experience in San Diego refutes this view - small units in the 150-180 square feet range have proven to be quite marketable. It is not clear how the harsher Canadian climate would affect the liveability and marketability of such small units. This is something that can be assessed only through actual experience. With the indicated rates of return there is some opportunity to experiment with size. Ideally, a mix that might span the range used here (175-210 square feet), and still generate a healthy rate of return.

Improved building efficiency (5% more units)

Depending on the specific features of a particular site, there may be opportunities to create a more efficient unit configuration and net-gross ratio. This could result from mixing some small (e.g. 175 sq. ft. units with the standard 210 sq. ft. used as the base case, or through reductions in hall width and lobby areas. For illustration, we assume a 5% increase in efficiency (effectively adding 2 units per floor for a total of 210 units instead of 200). This reduces the per unit costs for construction (to $35,600) and operations, reduces the equity requirement, increases operating income and cash flow, and increases the rate of return. However, the improvement is marginal (to 5.7%) at the multi-residential tax rate. At the residential rate, the return increases to 17%. If this construction efficiency can be attained, and taxation is at the residential rate, it appears that the project becomes a potentially viable investment.

Use lower cost wood-frame construction

In this scenario, the construction cost is reduced (to $70 per square foot, versus $80 for masonry construction). However, the numbers of floors and units are reduced (to three floors plus a basement and 175 units). If this revision were made on the same site it would represent an under utilization of the site and the land cost (total $972,000) on a per unit basis would rise to about $23 (versus $15 in the base analysis). This would offset any gain from lower cost construction costs. In this simulation we assume lower zoning with a FSR, more consistent with the resulting 3 storey (and habitable partial basement) building.

On this basis the total land cost, premised on the buildable square feet, drops to a total of $648,000. This cost saving combines with the lower wood-frame construction cost to generate a per unit cost of $34,300. At the same time, fewer units reduce the net operating income. Although the amount of investor equity falls, it remains almost the same proportion of the (now lower) total cost. At the multi-residential tax rate the return on equity is only marginally better than the base case - 5.2% versus 4.9; at the lower residential tax rate the return is better at 16.2%.

Provision of public (or charitable) land at no cost (or with a deferred lease)

Land is a substantial component (19%) of the cost. Eliminating this cost increases the rate of return to 7.2% (at the multi-residential rate), which remains below the 10% threshold. However, at the residential rate, the return is estimated at 45%. In the exhibit the land value is reflected at cost - the impact of the free land is instead represented as a reduction in investor equity. So in both tax scenarios, the investors cash equity is lessened by

$972,00- the actual land value. With this substantial reduction in the investors cash infusion (effectively, the provider of the free land is also contributing most of the equity), the rate of return improves substantially - especially in the residential tax option where the lower taxes raise the cash flow.

Reducing equity (to 85% of cost rather than of "lending value")

Although the high level of required investor equity was noted above as a serious impediment to investment, solving this problem by permitting a higher loan to value ratio does not help the rate of return. Essentially this substitutes mortgage debt for equity. The resulting amortization charges erode the cash flow and negatively impact the return of equity - to a very low return (0.8%) at the multi-residential rate, but a more attractive 12.4% return at the residential rate (a marginal improvement over the 11.8% base case).

High End Location

The "high end" scenario, envisions a better location (e.g. more central subway-oriented location) and assumes a rent of $500 per month. However, the better location also means higher land costs (assumed at $25 per buildable foot versus $15 in the base analysis) and higher construction costs (blended cost of $90 per foot versus $80 in the base analysis).

Once higher land costs and construction costs are factored-in, the high-end location shows a return that is not much different from the base case. However, the prospect of attracting a qualified "low maintenance" clientele - with which conventional rental developers may have a higher degree of comfort - might encourage some developers to investigate the option. Those investors might choose to utilize other assumptions that generate more attractive returns, so that this option should not be ruled out from a market perspective.

Another consideration under this option is the assumed minimal parking. Once the income profile of the tenants rises, the likelihood that some residents may be able to afford and desire to own a car may question the validity of exempting parking (or suggest a more modest parking requirement). This is a large additional cost item that will directly impact viability.

Adding a Commercial Component

A further refinement is to include a commercial component on the ground floor. The retail tenant is responsible for all operating costs and realty taxes while the space can yield, depending on location at least $12 per square foot. In this scenario, ground floor commercial space is substituted for 25 units. Because of the relative efficiency of the residential units - 65%, this provides 8,000 square feet of commercial area. Construction costs for the commercial are assumed at a lower $50 per foot.

On this basis a commercial component improves cash flow, reduces the equity requirement, and makes a marginal contribution to the rate of return. Assuming that the residential portion is taxed at the multi-residential rate the rate of return is 6.2%, versus 4.9% in the base case. Assuming residential taxation, the rate of return is 14.2%, versus

11.8% in the base case.

Conclusion

The results of the analysis suggest that from a financial feasibility perspective, the important factor is realty taxation. At the residential tax rate, most of the scenarios show returns within the target range of 10% to 15%. Addressing the tax issue is fundamental. Assuming that "the playing field is levelled", to tax new SRO accommodations as "residential" properties, it appears that returns may be in the target range (10% to 15% return on equity) and could stimulate new investment, without subsidies. In the "reality check" consultations (Part 3), we encountered a small group of investors who would seriously consider this housing form, if the conditions were right.

A number of other factors may also impact the potential to develop SRO's - these are discussed in Part 4. First we examine the second prototype, one targeted to the more traditional SRO population - former homeless "hard to house" and "at risk" individuals.

Developing Cost Estimates - Traditional SRO Option

The second component of this analysis considers the opportunity to encourage or facilitate private development of SRO type accommodation for the traditional clientele living in the rooming house and boarding house stock - potentially including individuals with mentally instability and victims of substance abuse. It is assumed here that the tenants would have some ability to live independently, but some may require a degree of community support, such as the monitoring provided by organizations like Houselink or Habitat services. Such supports would be funded separately and are not reflected in the developer/operator costs presented here. [9]

The site used for this simulation is smaller, totalling 10,822 square feet and has a sloping topography that permits a partial basement/ground floor with 3 floors above. The fronting street is commercial in nature with zoning for a mixed commercial residential use. To simplify the comparison and focus only on the residential cost only, the commercial area located on the ground floor (3,600 sq.ft.) is excluded in the initial analysis.

Assumptions

- With this target market in mind, the expected rents are lower than those in the earlier private market SRO. We assume $325 as a starting point as this is the current shelter component of welfare for singles. There is evidence of rents closer to $400 in the existing stock so a new product might command higher rents, however given the

[9] These non-profit community agencies provide a monitoring service, visiting existing rooming/boarding homes to ensure levels of operators meet specified maintenance and housekeeping standards and where necessary provide co-ordination of support services from other agencies. Separate support services provide counseling and basic health monitoring, including emergency response related to episodic mental illness.

objective of making the units affordable, we initially used this $325 level.

- We have assumed that the individual units will contain sleeping and private bathroom, but no kitchenette (a small bar fridge may be installed to keep perishables. Instead, common kitchens are provided with each 12 rooms sharing this space - approximately 250 square feet with a range and microwave sink, dishwasher and fridge. This is essentially a typical kitchen.

- In modelling this "Traditional SRO" we have used the smaller site, primarily as most informants suggested that very large properties create management problems. At the same time we need to generate some economies of scale.

- In an effort to improve efficiency narrower halls (42" width) are provided. However, after allowing for the common kitchens and the main floor lobby and administrative space, a net to gross efficiency of only 53% is achieved (including common kitchens in net area raises efficiency to 62%).

- Again, based on recommendations of existing providers, we have used non-combustible masonry construction. The structure contains a ground floor, including commercial space (excluded from this calculation and costing) as well as a manager's suite, office mechanical rooms and storage. Because of the gradient across the site, this level is technically a basement, and 3 residential storeys are provided on the 1-3rd floor. Each floor has 25 units and two common kitchen/dining areas.

- It is assumed that lower cost land ($15 per buildable foot) is secured.

- Operating costs are calculated on the basis of $4.00 per year per (net) square foot. In addition, there is an allowance of $55,000 for staffing (part-time cleaning staff, front desk and night security). The combination of low net-gross efficiency and the smaller scale of this project results in a high per foot operating cost. Including the allowance for staffing, this amounts to just over $10 per square foot (net), compared to the $5.30 that is used above for the market SRO (and $4 in conventional apartments - the basis of the industry norm).

The proforma for this base case traditional SRO is summarized in Exhibit 2.5. This reveals that the smaller units generate a substantially lower cost per unit ($26,100), despite the poor overall efficiency of the building. However, this lower per unit cost is more than offset by the relatively low rents, set at $325 per month. This constrains the net operating income and accordingly lowers the lending value and amount of financing that the project can support. The lending value is estimated at $1.35 million, compared with a cost of $1.95 million. A loan at 85% of value can finance only $1.15 million so the investor's equity must cover 41% of the cost. The return on equity (in year one) is only 3.6% (based on the multi-residential tax class).

Ways to Enhance Potential Returns and Attract Private Investors - Traditional SRO

As was the case in the earlier market SRO model, the rate of return in the base case for this traditional SRO model (3.6%) is insufficient to attract private development. Even with inflation growth in revenues of 2% annually, the return reaches only 4.9% by the 5th year.

A number of variations to the base case have been examined to determine if it is possible to make this development economically feasible. As we did in the previous market case, the options are grouped in combination with the two tax rates - the existing multi-residential rate, and the potentially lower residential (condo) rate.

Firstly, a set of scenarios explores realty taxation at the lower residential rate. For both tax scenarios, the following variations have been explored:

- Increase rent to $375/month
- Provision of public (or charitable) land at no cost (or a deferred lease)
- Use lower cost wood-frame construction (this also reduces total density)
- Add a commercial/retail component
- For comparison with the previous larger site an option providing self-contained units, at 210 square feet is also presented.

The impacts of these variations are summarized in Exhibit 2.6. The upper half of the exhibit displays the results assuming multi-residential taxation, in the lower half, residential taxation is assumed. As expected, the reduction in the tax rate has the most significant impact, raising the initial rate of return from 3.6% to 9.1%, still too low to be attractive, but getting close to the minimum acceptable level.

SRO Proforma Exhibit 2.5 Traditional SRO

75 units at 120 sq. ft (Private Bath & Shared Kitchen)

(Site 100'x 109' = 20944 sq ft) **Property Tax Class:** **Multi-Residential Rental**

4 Storey Walk-up Apartment (Masonry) Net-Gross Efficiency 53%

PROJECT DEVELOPMENT COSTS

	Project	Per Unit
Land	257,303	3,431
Construction	1,339,875	17,865
Soft Costs	233,489	3,113
Sub Total	1,830,666	24,409
GST	128,147	1,709
Total Costs	1,958,813	26,118

PROJECT FINANCING

	Project	Per Unit
Equity	804,050	10,721
Financing	1,154,763	15,397
		0
Total Costs	1,958,813	26,118
Mtg Ins Fee	57,738	770
Total Financing	1,212,502	16,167

ANNUAL REVENUES, COSTS AND CASH FLOW (Yr 1)

		Project	Per Unit	
Revenues:	Rental Income	292,500	3,900	
	Other Income	0	0	
	Vacancy Allowance (5%)	-14,625	-195	
	Gross Income	277,875	3,705	
Operating Costs:	Maintenance and Operations	36,000	480	
	Staffing/Maid Service	55,000	733	
	Property Taxes	64,606	861	
	Total Operating Costs	155,606	2,075	
	Net Operating Income	122,269	1,630	
Mortgage Payments:	Principal	21,821	291	
	Interest	71,271	950	
	Total	93,092	1,241	
	Debt Coverage Ratio	1.31		*Yr 5*
	Cash Flow	29,177	389	39256
	Return (Cash on Cash)	3.6%		4.9%

Alternative simulations show results as follows.

Higher rent

Assuming a rent at $375 per month and the multi residential tax rate, the analysis shows a return of 7.2%. This is an improvement but still too low. Only at $400 does the return move above the 10% threshold. Considering the nature of the client group, an investor would very likely expect a return at the high end of the target range (10-15%) Thus, it may be necessary to assume a rent closer to $425 to entice this investment.

At the lower residential tax rate, net operating income is increased sufficiently that, in principal, 99% of the cost could be financed with very minimal equity is required - generating a return of over 200%. Clearly this is not a realistic assumption - lenders will require minimal equity of 15%. Assuming an equity investment of $294,000 a healthy return of 24.1% is generated. This would be quite attractive and could stimulate development.

Free land

While labeled free land, this option could involve an arrangement involving leasing and deferred payments. The "free land is reflected in exhibit 2.6 as equity, under the multi residential tax this component is reduced from $804,000 in the base case to $547,000. Although the unit cost is still shown at $26,100, removing the cash outlay for land effectively drops the per unit cost to only $22,700.

The impact of this land contribution is to reduce the investors cash equity while the cash flow remains unchanged. Accordingly, the rate of return improves - to 5.3 under the higher tax assumption but to a more favourable 22.8% when in combination with the lower residential tax rate.

Wood frame construction

In this case, the property is small enough that there is no loss of storeys or units to facilitate wood-frame construction. Thus this option has a more positive effect than on the larger site. The lower cost wood-frame construction results in a modest improvement in the rate of return (at the multi-residential tax rate, to 4.9% versus the 3.6% base case). At the residential tax rate, the return increases to more than 21%.

This investment appears to be financially feasible, provided that wood frame construction is acceptable to the stakeholders - including lenders, investors, regulators, and tenants.

Exhibit 2.6 Options to Enhance Project Feasibility - Traditional SRO						
Multi Residential Taxes						
	Base Case	Higher Rent	Free Land	Wood-frame construction	Add Commercial	self contained 210 ft units
Total Units	75	75	75	75	75	60
Rent (Monthly)	$325	$375	$325	$325	$325	$325
Commercial Rent ($/Ft)	$12	$12	$12	$12	$12	$12
Unit Size	120	120	120	120	120	210
Blended Construction Cost	$79	$79	$79	$69	$80	$79
Net/Gross Efficiency	53%	53%	53%	53%	53%	74%
Total Construction Cost	$1,339,875	$1,339,875	$1,339,875	$1,162,425	$1,812,375	$1,350,900
Total Soft Cost	$233,489	$233,489	$233,489	$212,172	$293,378	$227,354
Land Cost ($/Buildable Ft)	$253,500	$253,500	$253,500	$253,500	$307,500	$255,600
Total Project cost	$1,958,813	$1,958,813	$1,958,813	$1,746,133	$2,587,116	$1,966,326
Cost/Unit	$26,118	$26,118	$26,118	$23,282	$34,495	$32,772
Net Operating Income	$122,269	$155,080	$122,269	$122,269	$163,309	$65,215
Lending Value	$1,358,545	$1,723,108	$1,358,545	$1,358,545	$1,814,545	$724,614
Maximum Loan @85%	$1,154,763	$1,464,641	$1,154,763	$1,154,763	$1,542,363	$615,922
Investor Equity Required	$804,050	$494,172	$546,747	$591,370	$1,044,753	$1,350,404
Equity as % Cost	41%	25%	28%	34%	40%	69%
Cash Flow Year 1	$29,177	$37,007	$29,177	$29,177	$38,970	$15,562
Cash on Cash Return Year 1	3.6%	7.5%	5.3%	4.9%	3.7%	1.2%

Adding a commercial component

In describing this site, we noted that the current zoning and the nature of the fronting street require the basement/ground floor to contain some commercial space. This was excluded from the initial calculations to focus specifically on the impact of the alternate refinements on the residential component (essentially this reflects building a smaller building without the commercial area). Here we add the commercial space. Unlike the larger site where this involved substituting commercial for residential areas, here it is an addition - no SRO units are lost.

Exhibit 2.6 (cont'd) Traditional SRO						
Residential (Condo) Taxes						
	New Base Case	Higher Rent	Free Land	Wood-frame construction	Add Commercial	self contained 210 ft units
Total Units	75	75	75	75	75	60
Rent (Monthly)	$325	$375	$325	$325	$325	$325
Commercial Rent ($/Ft)	$12	$12	$12	$12	$12	$12
Unit Size	120	120	120	120	120	210
Blended Construction Cost	$79	$79	$79	$69	$80	$79
Net/Gross Efficiency	53%	53%	53%	53%	53%	74%
Total Construction Cost	$1,339,875	$1,339,875	$1,339,875	$1,162,425	$1,812,375	$1,350,900
Total Soft Cost	$233,489	$233,489	$233,489	$212,172	$293,378	$227,354
Land Cost ($/Buildable Ft)	$253,500	$253,500	$253,500	$253,500	$307,500	$255,600
Total Project cost	$1,958,813	$1,958,813	$1,958,813	$1,746,133	$2,587,116	$1,966,326
Cost/Unit	$26,118	$26,118	$26,118	$23,282	$34,495	$32,772
Net Operating Income	$162,194	$204,944	$162,194	$164,874	$195,317	$92,124
Lending Value	$1,802,155	$2,277,155	$1,802,155	$1,831,930	$2,170,193	$1,023,603
Maximum Loan @85%	$1,531,832	$1,935,582	$1,531,832	$1,557,141	$1,844,664	$870,063
Investor Equity Required	$426,981	$23,231	$169,679	$188,992	$742,452	$1,096,263
Equity as % Cost	22%	1%	9%	11%	29%	56%
Cash Flow Year 1	$38,704	$48,906	$38,704	$39,344	$46,609	$21,984
Cash on Cash Return Year 1	9.1%	210.5%	22.8%	20.8%	6.3%	2.0%

Again we assume lower construction costs on the 3,600 square feet of commercial area and a commercial lease rate of $12 net. This generates surplus revenue and augments the cash flow, improving the return to 6.0% with multi residential taxes and to 17.7% at the lower residential tax rate.

Self-contained option

An option providing self-contained units (but eliminating shared facilities) is presented primarily as a comparison with the earlier "market SRO" model, primarily to illustrate the impact of developing on a smaller site. Effectively, this results in a larger amount of required construction per occupant - for the same amount of floor area, the number of units is reduced. The reduction in total revenue, a combination of fewer units and lower rent per unit of $325, results in a low lending value; a very high equity requirement (74% of cost in the multi-residential scenario); and a very low rate of return of less than 2%. This is the least viable option, even at the residential tax rate.

Conclusions - Traditional SRO Option

An important caveat on these rates of return is that longer-term projections may reveal restricted cash revenues, especially if targeted to welfare and marginally or casually employed individuals. The potential to sustain rent increases may be limited. However,

operating expenses will be subject to inflationary pressures. In more usual circumstances, investors might consider developments with marginal initial returns if there is some prospect of income growth over the longer term. This may not be the case here.

This exploration of the viability of serving a more "traditional SRO" clientele (welfare and marginally employed singles, some with behavioral difficulties, or illness), has found that the potential returns are quite marginal except where rents are pushed above the $325 limit, or land is subsidized. It was found that in most scenarios, this project could provide a positive cash flow only if there is a very substantial equity investment. This yields poor rates of return. Project financing has also been identified as a constraint. Lenders are unlikely to provide financing without CMHC insurance and both lenders and CMHC underwriters will likely take a conservative view in underwriting the project, as it is an unknown product, with relatively high risk.

One way to improve the viability of the project would be to reduce the equity requirement, by providing a second mortgage on concessionary (below market, or possibly interest-free) terms. This would, firstly, lower the amount of equity that must be raised (a significant hurdle). Secondly, by reducing the equity component of the rate-of-return calculation, the available cash flow would result in a higher rate of return.

A Non-Profit Option

For a non-profit operator, the investment analysis involves some different considerations. Firstly, return on equity is not a consideration - in fact the preference would be to generate no return and keep rents as low as possible. Alternatively, a non-profit operator can - by foresaking a positive cash flow - use the available positive cash flow revenues to finance a higher level of debt (some surplus cash flow is desirable to ensure that a project remains viable and can cover unexpected expenses or revenue shortfall). Thus, financing to a debt coverage ratio of 1.1 (the minimum permitted by CMHC) will still provide an operating surplus of 10% (above expenses).

Exhibit 2.7 illustrates the proforma for the "traditional SRO", undertaken by a non-profit developer/operator.

SRO Proforma Exhibit 2.7 Traditional SRO - Non Profit

75 units at 120 sq. ft (Private Bath & Shared Kitchen)

(Site 100'x 109' = 20944 sq ft) **Property Tax Class:** **Residential/Condo**

4 Storey Walk-up Apartment (Masonry) Net-Gross Efficiency 53%

PROJECT DEVELOPMENT COSTS

	Project	Per Unit
Land	0	0
Construction	1,339,875	17,865
Soft Costs	227,887	3,038
Sub Total	1,567,762	20,903
GST	54,872	732
Total Costs	1,622,633	21,635

PROJECT FINANCING

	Project	Per Unit
Equity	0	0
Financing	1,622,633	21,635
		0
Total Costs	1,622,633	21,635
Mtg Ins Fee	81,132	1,082
Total Financing	1,703,765	22,717

ANNUAL REVENUES, COSTS AND CASH FLOW (Yr 1)

		Project	Per Unit	
Revenues:	Rental Income	292,500	3,900	
	Other Income	0	0	
	Vacancy Allowance (5%)	-14,625	-195	
	Gross Income	277,875	3,705	
Operating Costs:	Maintenance and Operations	36,000	480	
	Staffing/Maid Service	55,000	733	
	Property Taxes	23,639	315	
	Total Operating Costs	114,639	1,529	
	Net Operating Income	163,236	2,176	
Mortgage Payments:	Principal	30,663	409	
	Interest	100,147	1,335	
	Total	130,810	1,744	
	Debt Coverage Ratio	1.25		*Yr 5*
	Cash Flow	32,426	432	45882
	Return (Cash on Cash)	n/a		n/a

Another advantage of a non-profit development is it qualifies for a GST rebate, effectively lowering the GST payable to 3.5% (contributing a $73,000 reducing to capital costs compared with the base case in Exhibit 2.5).

Assumptions

- This building configuration and size remain as in the preceding Traditional SRO (exhibit 2.5), still with masonry construction

- Land is provided at no cost to the project (essentially a grant equivalent to the land cost of $340,000 or $4,500 per unit). The land effectively represents equity, with no cash equity being required. The land contribution could be in the form of a land lease, to protect the future affordability and maintain public control.

- Operating expenses are based on the industry norm used in the previous example, including the staffing allowance of $55,000. Hence the non -profit operator would have to maintain the same level of operating efficiency as a private operator.

- Realty tax is based on the lower residential (condo) rate, with the assessed value equal to the cost of the project (including the value of the land). With these assumptions, the project is able to support 100% of the debt service costs and still generates a surplus of some $32,400. Moreover the project still has a DRC of 1.27 [10]

Financing parameters are crucial. In that regard, it is important to distinguish between "loan to value" and "loan to cost". In exhibit 2.7 we identify the loan amount at $1,622,633, which represents 100% of the cost, excluding land, or 85% including the land value. However based on the CMHC underwriting approach, with a cap rate of 9% and multi-residential tax rate, the project would yield a value of $1, 619,600, effectively a loan to value ratio of 100%. [11]

Financing at 100% of cost would require mortgage insurance, but may be unacceptable to CMHC underwriters, without some form of additional loan guarantee. A solution might take the form of a loan guarantee from the government, or could be addressed by providing a second mortgage covering the difference between the maximum first mortgage (85% of lending value) and the total amount financed here. This mortgage could be provided at cost by the province (whose borrowing rate should permit a mortgage of no more than the 6% used here).

As shown in Exhibit 2.7, the project is able to cover debt serving on the high ratio loan(s), and still generate a reasonable surplus (a contingency reserve) of $32,400. This would not

[10] If assessed at the multifamily tax rate, the project would require an infusion of $264,000 as cash equity to maintain a DCR of 1.10. Thus the option is not viable at current multi residential tax rates unless the non-profit developer is able to fund raise this level of equity.

[11] The 9.0% cap rate is a standard used by CMHC, but for this SRO form, for which there is no recent lending experience, CMHC and lenders may be more conservative, especially given uncertainty about future revenue growth. Thus they may establish a lower lending value, and accordingly generate a higher loan-value ratio.

be a subsidized program (although the guarantee or second mortgage represents a form of assistance and contingent liability to the province). Non-profits would compete on the same basis as a private developer - they would have to raise the necessary equity contribution. Their competitive advantage would be the lower GST, and possibly the more favourable underwriting treatment. A non-profit operator may also be a preferable landlord when accommodating at risk or hard to house tenants.

Summary: Feasibility of Traditional SRO Model/Clientele

This review indicates that the development of a SRO intended to serve a "marginalized" clientele, reflecting the existing profile of rooming house occupants, is unlikely to be attractive to private SRO operators without a number of concessions.

As a starting point, realty taxation must be based on the residential/farm class; not the multi-residential class that is currently applied to multi- unit residential properties. But even with this revision, it appears that returns are inadequate to attract investment. The critical issue is that the **target rents, premised on the $325 per month welfare shelter allowance, do not generate an acceptable rate of return**. In addition, in producing only a modest net operating income, the low rents constrain the lending value of the property, thereby increasing levels of required equity investment. The concern about potential to increase revenues over time is also a serious impediment to private investors.

While further enhancements such as using wood frame construction to reduce construction cost and locating on lower valued sites can improve the economics of development, returns remain marginal. Apart from increasing rents beyond $325, development economics begin the look reasonably attractive only when land is contributed for free or well below market value.

Part 3: Critical Issues and Barriers

In addition to the financial analysis, the study team consulted with the development industry, existing rooming house operators, architects, and regulators, in order to test attitudes to involvement, as well as to identify issues and constraints that must be addressed.

Issues identified can be grouped under the following categories:

- Regulatory and Code Constraints
- Cost Issues
- Revenue Potential
- Operating Practice
- Lending and Financing
- Investor Interest

Regulatory and Code Constraints

The SRO building form is effectively an anachronism and hybrid type of development that does not readily fit the parameters of the existing regulatory framework. It would be viewed as a residential hotel from most regulatory perspectives, and the building form and its operation will be subject to interpretation.

Zoning

From a zoning perspective, bylaws in Ontario jurisdictions typically define analogous uses such as "dwelling units", "rooming house units" and "boarding houses". To the extent that the SRO is intended for longer-term accommodation, it should logically be considered a residential dwelling use, as distinct from a tourist accommodation. This is particularly the case where the unit is equipped with both a bathroom and kitchenette, and the occupant is able to both prepare and eat meals. The alternative is to consider the SRO a temporary accommodation analogous to a hotel or motel. These are typically defined as a use providing sleeping accommodation for the public and licensed under the tourist act.

Zoning provisions tend to be more explicit and restrictive in the case of "residential dwellings" and as such these may impose the most significant impediment, most notably with respect to minimum size of units. The other critical impact of existing zoning provisions is the requirement for parking. While this varies by locale, at minimum a multi residential property will typically require at least 0.5 parking spaces for each dwelling plus an allowance for visitor parking.

In developing the proformas in section 2 of this report very minimal parking was provided, essentially for building staff, far below any existing bylaw requirements. It is argued here that parking should be minimized given both the target market, whose incomes are likely to be insufficient to afford ownership of a vehicle, and the proposed downtown locations in close proximity to public transportation. The cost of parking (at approximately $1,500

to $1,750 per surface space and at least $14,000 for below grade parking) is simply prohibitive. A relaxation from parking is essential. [12]

Building Code

The hybrid SRO use and form is again subject to interpretation under the Ontario Building Code.

Although not explicitly defined, a SRO use would clearly fall within the Major Occupancy classification Group C, which includes apartments, boarding houses, hostels, hotels, motels and lodging houses (OBC A 3.1.2.1(1))

The OBC defines a *dwelling unit* as a *suite* operated as a housekeeping unit, used or intended to be used as a domicile by 1 or more persons and usually containing cooking, eating living, sleeping and sanitary facilities. In turn, a suite "means a single room or series of rooms of complementary use, operated under a single tenancy and includes *dwelling units*, individual guest rooms in motels, hotels, boarding houses, rooming houses and dormitories as well as ...." (OBC 1.1.3.1)

From these definitions it is apparent that a SRO unit would be interpreted as a *dwelling unit* and, as such, would be subject to the code provision relating to minimum size. Potentially, where the SRO unit does not have a kitchen or cooking area, designating the building as a residential hotel may provide greater latitude under the code, but this is unlikely to avoid application of the specified minimum sizes.

Minimum unit size

Interpreting a SRO unit as a *dwelling unit* has significant implications. Section 9.5 of the OBC applies to *dwelling units* that are "intended for use on a continuing or year round basis as the principal residence of the occupant". This section of the code establishes minimum areas and spaces that, in combination, would exceed the unit sizes used in this analysis. More specifically:

- Where combined with kitchen and dining areas, the living area alone shall not be less than 118square feet (11m^2) room
- A dining space, where combined with other areas shall have an area of not less than 35 square feet (3.25m^2)
- A kitchen area, where provided in combination with other spaces, and in a unit containing sleeping accommodation for not more than 2 persons shall be a minimum of 40 square feet. (3.7m^2)

[12] As commercial parking is in high demand in downtown locations, one option is to develop the SRO over a commercial parking structure. The parking may generate sufficient income to cover its own cost and would provide parking in the event that some building tenants do in fact wish to lease a space, or in event of a future change in use of the building. This might also enhance the land cost for the SRO development.

- Bedroom areas, in combination with other space shall have an area of not less than 45 square feet ($4.2m^2$)
- Bathrooms and water closet shall be provided in an enclosed space of sufficient size to accommodate a water closet, lavatory and bathtub or shower stall.

So in total, the code establishes a minimum unit size of:
living area 118 square feet
dining space 35 square feet
kitchen area, 40 square feet.
Bedroom areas 45 square feet
238 square feet plus an enclosed bathroom sufficient to accommodate 3 fixtures (i.e. functionally at least 30 square feet) and circulation space within the unit.

Thus interpreting the SRO as a dwelling unit will establish a minimum unit size of at least 270 square feet, substantially larger than the areas used in the proformas.

However the code Section 9.5.1.5 (1) also states that: *the areas of rooms and spaces are permitted to be less than required in this Section [9.5] provided it can be shown that the rooms and spaces are adequate for their intended use, such as the provision of built in furniture to compensate for reduced sizes.*

In the event that the SRO unit is interpreted not to be a dwelling unit, the Section 9.5.7.4 (1) of the OBC provides a minimum unit size: *"Sleeping rooms other than in dwelling units shall have an area not less than 75 square feet for single occupancy..."*

Accessibility
Barrier Free requirements are established in Section 3.8 of the code, which applies to all buildings except houses, townhouses ... and boarding and rooming houses with fewer than 8 boarders or roomers. Generally the ground floor must be barrier free and fully accessible. It is not mandatory that other floors be accessible. Accordingly, an elevator is not mandatory, except in building exceeding a height of 59 Ft and more than six storeys.

Barrier free paths of travel are defined with a minimum width of 3 ft 6 inches, although the code further prescribes a minimum corridor width for any public corridor as 3 ft 7 inches (Section 3.3.1.9, and 9.9.3.3). In our design simulations we used a more generous 5-ft corridor in the larger market SRO prototype, but the minimum 3 ft 7 inches in the small "traditional SRO" model.

Elevator
As already indicated, an elevator is an optional feature below seven storeys. It is not a code requirement, but may be a marketing feature, especially in the market SRO model (where we included a single elevator, although given the building size two may be preferable). To avoid this cost no elevator was provided in the smaller traditional SRO prototype.

Sprinklering

Although non-combustible construction or sprinklering is likely desirable for the SRO use, based on history of fatal fires in such properties, the code does not necessarily prescribe these features. The requirements depend on the structure size, height, and number of facing streets. In the case of our larger prototype, the code would limit the building area to 10,800 sq. ft and three stories if constructed as wood-frame and not sprinklered (by building the lowest floor as a partial basement, four habitable floors are possible on this site).

Rooming House Licensing and the Tenant Protection Act

Currently, residents in licensed rooming and boarding houses are afforded some protection under the Tenant Protection Act. To the extent that a SRO may rent rooms on a short-term basis, some operators register under the Innkeepers Act and consequently may gain exemption from the Tenant Protection Act.

The current legislation is not precise - like the building code it is subject to interpretation. It would seem reasonable that a SRO be treated as a residential tenancy with tenants protected under this legislation. It is necessary to create or amend regulations that ensure that SRO's are treated as residential tenancies.

Summary of Regulatory Issues

It is clear that the SRO property is not explicitly recognized in existing zoning and building codes, although related uses such as rooming house and boarding house are identified. Thus any SRO proposal will be subject to interpretation, and acceptability may vary between jurisdictions. The most critical barriers to SRO development are parking requirements and potentially minimum areas prescribed in the Ontario Building Code. It would preferable for the provincial government, through the MMAH Building and Standards Branch to develop and promulgate model bylaws and an interpretive bulletin on code issues, specifically clarifying sections that may impact the development of SRO properties. It is notable that the private SRO development in California was stimulated initially by the development of special demonstration ordinance which detailed precise exceptions to the codes and bylaws that would have prevented SRO development (e.g. San Diego Living Unit Ordinance, Orange County SRO Development Guide).

Cost Issues

In developing the proformas and feasibility assessments in Part 2 costs were premised on industry norms and discussion with a number of developers and construction managers. Since the SRO is a relatively unique use, with no recent development on which to premise costs some assumptions are involved in developing the proformas in part 2.

The construction costs were premised on current construction norms of $65 per sq. ft for

wood-frame and $75 for masonry construction respectively.[13] In both cases, this is for basic construction to a relatively modest but durable standard. Separate allowances were used where surface parking ($1,500 per stall) and elevators ($60,000) were provided.

Another consideration is the relatively higher number of kitchen and bathroom installations (i.e. approximately one of each every 200 square feet versus one every 600 plus square feet in a conventional one or two bedroom modest apartment). Discussion with construction managers suggested that the $65 and $75 estimates should be adequate to cover these costs, largely because of other savings that arise from the low efficiency of these structures (i.e. higher proportion of circulation spaces including lobby and hallways which average overall costs down.)

This wood frame cost $65 was retained in the traditional SRO model, even though in this case the private kitchenette was eliminated and replaced with a common shared kitchen/social room. The elimination of these kitchen appliances and related finishes is likely to generate a saving and lower the cost per foot. Allowing $1,500 for the saved cost of each kitchenette in 75 units (reflecting cost of complete mini-fridge, microwave and hotplate combination unit) while also providing an allowance of $4,000 for the appliances in six common kitchens, generates a net saving of approximately $5 per square foot. So the construction cost of this traditional SRO base case may be overstated. On the other hand, the recommended option of sprinklering the wood-frame option was not reflected in the proforma - this too carries a cost approximating $5 per square feet. Thus the savings in reduced kitchens nets out against the increased cost of sprinklering.

To estimate operating costs, the proformas take as a starting point an industry standard of $4.00 per net rentable square feet, which includes staff costs, energy, and miscellaneous costs. On a gross footage basis in conventional one and two bedroom apartments with 85% net-gross efficiencies, this works out to about $3.40. In our analysis we retained the $4 per net foot norm, but this is applied against a lower net to gross ratio. This factors up to a slightly higher amount, at about $3.45 per gross foot. This norm may not translate directly to a SRO property, as it may experience higher turnover, impacting both maintenance costs and administration (re managing move in and related paperwork). Thus, the estimate of operating costs may be low.

In the SRO model, staff costs have included an allowance of $55,000 for maid/linen service (2 part time cleaners at $8,000/yr) a desk clerk at $20,000 and night security ($15,000) plus relief desk security at $4,000).

In Part 2 the costs were based on those expected in downtown Toronto, since these tend to be the highest in the province so if the SRO option is feasible in this location it should

[13] Exhibits 2.4 and 2.6 reflect a blended hard construction cost which includes the parking, elevator where applicable, and a 5% construction contingency resulting in base costs of $69-$70 (wood-frame) and $80 (masonry).

be more so in other urban locales, such as Ottawa. As indicated in Exhibit 3.1 below, SRO development may be substantially more viable in Ottawa where land costs are significantly lower and construction costs may be marginally lower (although no adjustment for lower construction has been used in Exhibit 3.1).

Because rents are premised on the welfare standard, which is uniform across the province, the revenue potential is identical in Ottawa, even though costs are lower.

The pervasive impact of the property tax rate is again quite evident. While lower land costs improve the economics in Ottawa returns remain inadequate when the property is taxed at the higher multi-residential rate. However, at the residential (condo rate) the rate of return under both masonry and wood-frame construction is well above the target range for investors.

Exhibit 3.1 Relative Feasibility in Toronto and Ottawa - Traditional SRO				
(reflecting lower land costs in Ottawa)				
	Masonry		Wood-frame	
Multi Residential Tax Rate	Toronto	Ottawa	Toronto	Ottawa
Cost/Unit	$26,118	$24,867	$23,282	$22,032
Investor Equity Required	$804,050	$710,280	$591,370	$497,600
Cash on Cash Return- Yr 1	3.6%	4.1%	4.9%	5.9%
Residential (Condo) Tax Rate				
Multi Residential Tax Rate				
Cost/Unit	$26,118	$24,867	$23,282	$22,032
Investor Equity Required	$426,981	$322,053	$188,992	$84,064
Cash on Cash Return- Yr 1	9.1%	12.1%	20.8%	47.1%

Revenue Potential

In the two prototypes - market and traditional - we used market rents of $425 and $325 respectively. It has been demonstrated that for the market scenario, which include larger units with kitchen and bathroom, project economics are very unfavourable at the lower $325 rent level. It is clear that rents at the current welfare singles threshold are insufficient to generate a viable and attractive investment. Only when the building design was altered to eliminate private kitchenettes and thereby reduce unit size, or when lower cost wood-frame construction and lower land costs are achieved do the economics approach feasible levels.

In many cases, zoning as well as street level activity and noise recommend commercial or other non-residential use on the ground floor. This approach appears to generate surplus revenues, which can be used to augment the net income from the residential component. As we saw in each case, the inclusion of commercial space even at modest rents improved the cash flow and rate of return.

Another option, footnoted above is the possibility of building the SRO over a commercial parkade.

Operating Practice

The operating practices of the recent SRO's in the US have been extensively reviewed. In the US, the properties tend to be much larger than we have explored here, offering considerably greater operating efficiencies. The US models also incorporate a fairly high service level - maid and linen service and high levels of security - imposing both hard costs in the form of surveillance cameras and operating expenses relating to staff. In the prototypes assessed in this report, these features have not been fully incorporated, although some allowance has been allocated to staffing. There is a critical trade-off between including such features, and enhancing the management and marketability of each project, and the associated costs, which act to undermine the economics.

Again the San Diego experience is illustrative. Properties that did not or have not established and maintained a very proactive management system have tended to experience difficulties.

In addition to the proactive professional management model, the other genre of successful project in the US have been those operated by a long time owner who is actively involved in the property - almost a "Mom and Pop" management model. The operator tends to know many of the residents, especially given a high proportion of long term residents, and an informal social structure tends to exist in these properties. This is a special breed of operator that tends to have a strong relationship with community agencies and knows the street population.

Clearly the opportunity to attract such operators is very limited, but some existing experienced rooming house operators have expressed some interest in developing and operating new properties - their opportunities are however restricted by the regulatory and financing constraints.

These existing operators know the business and the traditional population and have suggested that larger self-contained mini-suites are not necessary. They suggest rooms of 120 square feet may be adequate and full kitchenettes in all units are unnecessary (this reflects the requirements of a single male population, females may prefer the private cooking).

Another model that is not explored here is the option of developing shared units providing 4-6 private beds in a units that provides common bathrooms, kitchen, dining and living areas. A number of such developments are currently proposed or under construction in some cities. As the terms of reference for the current study focused on the market option, these have not been examined in any detail.

Lending and Financing

One of the most critical constraints challenging both potential SRO development and rental development in general is the difficulty is securing project financing. As discussed in great detail in Lampert (1995, 1998), and reviewed here in Part 2 the underwriting practice of lenders is strongly influenced by CMHC in its capacity as a mortgage insurance agency. Because rental development has historically had a record of relatively high default, and is consequently considered higher risk, underwriting practices tend to be very conservative. This limits the level of financing available and requires potential investors to contribute prohibitively high levels of equity.

These difficulties are exacerbated in any endeavor that seeks to produce an affordable product - mainly because low rents generate low net income, which directly determines the lending value. At rents of only $350 in the market SRO, only half of the $8 million project cost can be covered by financing - this situation improves substantially as high rent levels ($425-450) are achieved, but at the cost of lower affordability.

The more favourable proformas reflect the assumption of the lower residential farm class (condo) taxes. The provisions of the Fair Municipal Tax Act to establish a new property class and lower tax assessment for new rental contain a serious impediment. The legislation currents permits new rental properties to be assessed in this class for only eight years. After this time, the taxes would be assessed on the same basis as existing multi residential - with taxes more than doubling as a consequence.

Not only does this impact the future rates of return, but lenders will be extremely concerned about the impact on project viability - the CMHC experience in underwriting rental properties is that the greatest default risk is in the 10-15th year. As a consequence, lenders will continue to underwrite the property based on the higher multi residential class. This effectively doubles taxes, undermines the NOI and most significantly, constrains the eligible level of the maximum loan. Faced with a higher level of equity investment, most potential developers will not pursue this option, opting instead to pursue alternative investment, such as luxury rental or condominium. It is imperative that the province amend the Act to eliminate this eight-year guillotine.

Investor Interest

In the course of the "reality check" we met with potential investors including senior staff at very large real estate companies (public and private) and a number of smaller existing rooming house operators. All are experienced housing providers, spanning both the conventional apartment market and the SRO/rooming house sector. . They are clearly believers in the importance of creating affordable housing.

Their interest is, for the most part, the "market" tenant - typically a student or low-wage employee, who needs affordable housing but does not need supports. Some of the investors would build high-end projects (with rents of, say, $450-$500). Their opinion is

that any housing supply makes a contribution to addressing homelessness. Others show motivations that combine investment returns with contributing a social good - they are very interested in building communities of people who are safely and affordably housed.

All of these contacts assess market rent for SRO's as $400 or more - none of them see $325 as realistic in the market.

These contacts have reported on concerns that are preventing them from providing SRO housing, including:

- the difficulty of obtaining approvals, when any zoning application would be highly contentious (essentially, in their view, the middle class is discriminating against those with lower incomes)
- the difficulty of obtaining affordable financing, either form conventional lenders or with CMHC insurance
- parking requirements
- in the case of public companies, resistance from shareholders and/or senior managers to be involved in potentially risky or controversial projects
- the realty tax situation.

Notwithstanding these impediments, there is clearly interest in the SRO housing form, and there are good prospects that removal of the obstacles could be followed by some (though not a great deal) of new investment, provided reasonable rates of return can be achieved.

Part 4: Conclusions and Recommendations

This review has examined the potential to develop small suite single room occupancy accommodations with no public subsidies. A financial analysis of this development form has been used to assess potential rates of return, in order to make a preliminary assessment of investor interest. Two model prototypes have been created, drawing from the recent experience in other jurisdictions:

- "Market SRO", which would serve low-wage working singles who do not need social supports. The client group includes both younger singles at the beginning of their working life in entry positions as well as more mature singles working in the service industry for modest wages
- "Traditional SRO" would target former or at-risk homeless individuals, who are able to live independently with minimal support.

The primary focus here has been on providing accommodations to low income singles who are capable of living independently. This reflects the findings reported in Part 1 that there is a strong demand for low-to-moderate rent accommodations, from more than 360,000 non-elderly single renters - many of these people require housing renting below $500 per month.

The experiences in other jurisdictions, augmented by a number of recent research studies, suggest a minimum unit size of 210 square feet for "self contained mini suites". This basic unit size was adopted in the "Market SRO" prototype. A smaller unit, without the kitchenette, was used in modeling a property for the more traditional SRO clientele. This suite was modeled at 120 square feet.

In exploring different unit sizes and building configurations a significant design issue was identified. The small suite SRO design imposes a limitation in the form of poor building economics. The small size of the suite - particularly their relatively shallow depth (10-16 feet, compared with 24-30 feet in standard one or two bedroom apartments). This generates low net to gross efficiency as a disproportionately greater area of hallway is required for each suite. Typically in standard multi-family projects a developer will seek to achieve 80-85% net/gross efficiency (i.e. rentable floor area as a proportion of total gross floor area). In a range of prototypes with varying suite size (120 square feet to 250 square feet) we were only able to achieve efficiencies in the range of 58-65%. This impacts total costs, and despite their small size increases the average cost of each unit.

The results of the analysis suggest that from a financial feasibility perspective, the important factor is realty taxation. At the residential tax rate, most of the scenarios show returns within the target range of 10% to 15%. Addressing the tax issue is fundamental. Assuming that "the playing field is levelled", to tax new SRO accommodations as "residential" properties, it appears that returns may be in the target range (10% to 15% return on equity) and could stimulate new investment, without subsidies.

This exploration of the viability of serving a more "traditional SRO" clientele (welfare and marginally employed singles, some with behavioral difficulties, or illness), has found that the potential returns are quite marginal except where rents are pushed above the $325 limit, or land is subsidized. It was found that in most scenarios, this project could provide a positive cash flow only if there is a very substantial equity investment.

The consultations conducted with industry suggested that there is some latent interest in the SRO housing form. Any SRO housing created would most likely be for "market" tenants (who do not require supports). Market rents for SRO housing will likely be in the region of $400 to $425 per month. Operators find that given the shortage of low cost housing, they can choose very good tenants, and hard-to-house tenants will tend to get excluded -possibly an argument to encourage non-profit SRO development.

Target rents, premised on the $325 per month welfare shelter allowance, do not generate an acceptable rate of return.

However, the key findings from the financial analysis are that, even if developers wished to pursue this option, the prototypes described in the report could not be developed under current regulatory frameworks. There are three critical impediments:

1. The building code establishes minimum areas by function. Aggregating these areas generates a minimum suite size of 275 square feet. Current zoning may also establish minimum suite sizes in excess of the areas used here.
2. Current zoning regulations typically require parking on a ratio of at least 0.5 spaces per suite - the modeled SRO's are premised on almost no parking.
3. At the targeted affordable rents of $325-$425, the "multi-residential" property tax rate is prohibitively high - it is not possible to generate sufficient net income to provide a reasonable return on equity. A minimum condition for viability is that property taxes must be at the "residential/farm class" rate (which applies to condominiums as well as conventional ground-oriented housing forms of ownership housing).

In assessing feasibility the critical benchmark is the return on investor equity. Investor developers indicated that they would seek rates of return in the range of 10-15%, more likely at the higher end of this range, given the relatively high risk associated with this new low income housing product.

The two base cases (one each for the "market" and "traditional" prototypes) generate unattractive rates of return at the multi-residential tax rate. However, the "market" product just enters the acceptable range, when taxed at the lower residential rate.

Base Case Return on Equity		
	Market SRO (200 units @ 210 sq. ft)	Traditional SRO (75 units @ 120 sq. ft.)
Multi-Residential Tax Rate	4.9%	3.6%
Residential (Condo) Tax Rate	11.8%	9.1%

In addition to financial analysis, other factors will be involved in making positive investment decisions:

- Potential investors may view SRO's as higher risk, compared to more traditional housing forms (including condominiums and conventionally-sized rentals). In the final analysis, therefore, an investor may require returns at the high end of the target range (15%). Few of the scenarios reached the 15% rate, even at the residential tax rate.
- It is assumed that municipal requirements will not impose significant costs. For example, that there will be no development charges for this form of housing, most fees and levies will be waived (e.g. parks, school and road, storm and sewer levies) and parking requirements will be minimized , at substantially below normal requirements.
- "Approvability" may be an issue, as, depending on location, any proposed zoning amendments will be harshly opposed by local residents. However, this may be less of an issue in downtown mixed use areas. Ideally, SRO's should not be seen as special cases that require demanding approval processes.
- The ability to obtain financing, under the terms assumed, is questionable. The analysis makes assumptions about financing that are based on conventional lending practices. From a lender's perspective, there is risk related to the unconventional housing form. As well, many of the investors who might consider this housing form might have difficulty persuading a lender that they have sufficient expertise to complete a construction program, and then to manage the project.
- Even if take-out financing is obtainable, it may be difficult to get construction financing at realistic interest rates. If interim finance is at high rates, the increase in total costs will make projects unviable.
- Based on conventional lending parameters, equity requirements will be very high, which may discourage some otherwise qualified investors.

Given the elements of uncertainty, it may be necessary to kick-start the development process through government participation in one or two demonstration projects. The governmental contribution should address the impediments identified by this report, by including elements such as low interest rate interim financing, second mortgage financing (to reduce equity requirements), reduced land costs, fast-tracked approvals, waiving of all municipal fees and charges, and no parking requirement.

Potential Incentives and Enhancements

Various refinements to the base case model were explored and generally these were found to have a small positive impact on the overall attractiveness of the SRO development.

These included:

- Reducing the unit size to 175 square feet, which enhances revenues by facilitating additional units. However, the marketability of these smaller sized units is uncertain;
- Improving the building efficiency (this will be subject to site features);
- Using woodframe construction (subject to still maximizing site potential to gain full value from land cost); and
- Adding commercial space - with revenues augmenting the residential income.

Alone, none of these is sufficient to make a development viable - however ion combination these measures help to enhance potential returns.

The most significant enhancement involved securing land at below market rates. This can be achieved in two ways. The first is by proving some form of density bonusing related to affordable SRO development so that this use could purchase land valued at a lower density. This option could be pursued in a larger development in which part of a site is developed with more profitable larger units for the modest condominium or rental market, with a portion as SRO development. Effectively, the density bonus would permit sufficient additional density on the non SRO portion of the site to lower or eliminate the land component cost for the SRO.

The other possibility is for government to provide land on a leasehold basis, with some form of favourable lease payment sufficient to improve economics - e.g. a deferred escalation in an annual ground rent. This can be structured to ensure a return to government - it does not have to be a subsidy.

Impact of "Free Land" on Return on Equity		
	Market SRO (200 units @ 210 sq. ft)	Traditional SRO (75 units @ 120 sq. ft.)
Multi-Residential Tax Rate	7.8%	6.0%
Residential (Condo) Tax Rate	45%	22.8%

In Part 2 we found that free land, in combination with the lower tax rate generated a very good return, 23% for the smaller traditional model and 45% in the market model. These rates of return suggest that it may not be necessary to provide land at no cost - some level of below market discounting or deferral of payment may be sufficient.

In Part 2 we also identified the option of a non-profit development. Here the critical issue is the lack of equity and inability to secure financing. It has been shown that the property can be viable and generate a positive cash flow, with a safe debt coverage ratio, even with 100% financing. The Non-profit does not wish or need to generate a profit, beyond a modest cash flow to establish operating and a capital reserve. It is suggested that a government second mortgage might provide a means for non-profit based organizations to pursue SRO development. Again, the second mortgage does not have to be a subsidy - government can receive a fair return to cover its favourable cost of borrowing.

Recommendations

If the Ministry wishes to encourage private sector development of SRO type accommodation there is a clear need for leadership and facilitation. The following steps are prerequisite:

1. The Fair Municipal Tax Act should be amended to remove the current eight-year limit on the use of a new tax class for rental housing development.
2. MMAH should develop a policy guideline providing clear interpretation of the Ontario Building Code and residential tenancy legislation as this relates to SRO development. Where necessary amendment to regulations or legislation should be pursued. Model zoning bylaws should be developed to guide municipalities in developing zoning and building bylaws that encourage SRO development.
3. The province should initiate a demonstration call for proposals, ideally in partnership with municipalities, and using publicly owned land. This should establish some basic ground rules sufficient to stimulate innovation and creativity. The process should be one that enables private sector partners to clearly determine feasibility and proceed to development with assurance that delays will not be encountered for this new building form.
4. Based on the results of the demonstration, further adjustments to the regulatory framework should be considered as appropriate.

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Appendices

Appendix A: Recent SRO/Small Suite Developments in US and Canada

Appendixes B: Schematic Floor Plans for Prototype Sites.

Appendix A: Recent SRO/Small Suite Developments in US and Canada

To provide a sense of the recent SRO development some initiatives are briefly described below. Here we include both market-based projects and some of the more supportive developments.

San Diego:

As suggested above, while the impetus came from the loss of existing SRO stock, a number of the new private SRO developments in San Diego have been targeted to the working poor (including those in the lower wage service/hospitality industries, students and some fixed income elderly), rather than to chronic homeless. A fairly standard model has evolved - typically involving four-storey wood frame construction, with some commercial space on the ground floor. Underground parking was based on a bylaw requirement of 0.2 spaces per unit (although this can be lowered by provision of bicycle lockers and "in lieu of" fees). The properties provide 150-200 private rooms, ranging in size from 125 to 220 square feet and renting for $325-630 per month - some units receive city rent subsidies lowering rents to $200-$265.

The special livable unit ordinance adopted in San Diego in 1987 to encourage SRO development reduced minimum room size to only 70 sq. ft and made this a permitted use in any zone in where a hotel/motel use was allowed. Properties were designed as commercial for building code purposes and a special variance initially reduced or eliminated parking requirements.

Baltic Inn. One of the earliest ventures developed under the city's demonstration ordinance, Baltic Inn provides 204 rooms (typically 10'x12' and 10'x16) in a four storey wood frame structure. Each room has a standardized built in wall unit with toilet, sink, storage space, closet, refrigerator and TV (See illustration and floor plan). Common showers are provided on each floor. A common lounge, laundry, vending area and bicycle storage is provided on the main floor. The property is operated on a for profit basis by a private developer - however the City provided a low interest $500,000 loan (while a conventional mortgage covered $2.7 million of the cost).

Sara Frances Hometel. One of the first private SROs developed under San Diego's livable unit ordinance, this project provides 160 rooms in a four-storey wood frame building with an interior courtyard. Rooms range in size from 80-160 feet (without private bathroom - 50 rooms) to 125 to 220 sq. ft (with a private bathroom - 110 rooms). Each room is provided with a bed dresser, sink and mirror. Residents may rent a small fridge, microwave oven and telephone. A larger shared kitchen is provided on each floor. The

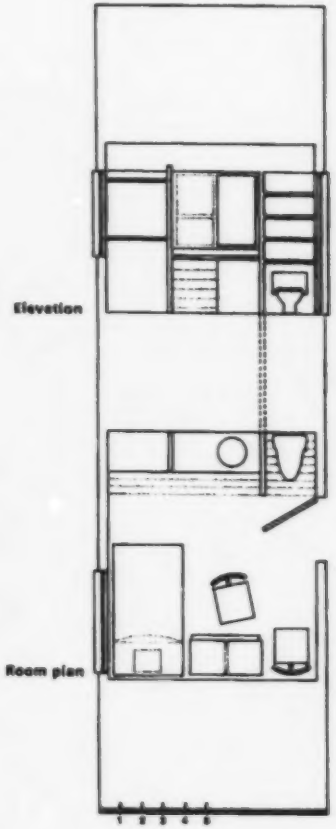
total construction costs averaged $16,200 per unit (1989). Project financing included two second mortgages (total $625,000) at below market rates from the City. Unlike other privately developed projects this one was targeted to the traditional SRO occupants - mainly older and disabled individuals. A 100-year-old SRO hotel that was destroyed by Fire in 1986 had previously occupied the site. Since the same owner already owned the land there was no land cost, a factor that enhanced the proforma. The units rent from $258-340 (in 1989) reflecting the range in unit sizes.

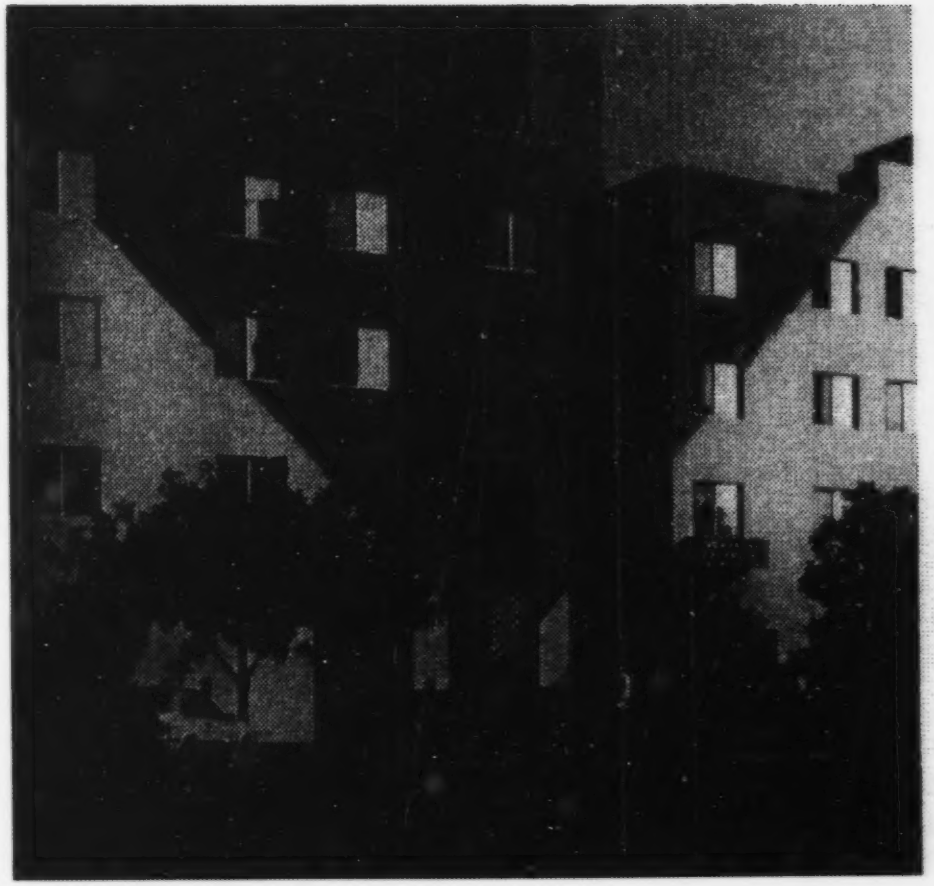
University Gardens - A seven-storey building (masonry construction) containing 151 rooms ranging from 164 to 240 square feet (larger size is for handicap accessible). All rooms have private bath and showers and telephone jacks (private phones available with a deposit). Tenants can also rent televisions, microwaves and refrigerators to place in rooms. A communal kitchen is provided on every other floor, as is a laundry. A social lounge/TV room is located on the main floor. A front desk is manned 24 hours, augmented by security cameras. The property is privately operated but in return for a low interest loan ($500,000) the developer provides 20% of the units to low income households at $225 monthly rent (market rents are $300-$350).

Campaige Place, Las Vegas. Currently under construction, a developer that built SROs in San Diego in 1987 and 1993 (Trolley Court and Peachtree Inn) is developing this new SRO. This project is similarly targeted to independent working poor (earning between $8,000-16,000 annually) - particularly those working in the Tourism industry in Las Vegas. The project follows a fairly prototypical four storey wood frame configuration and contains 320 rooms. These range in size from 150 sq. feet to 250 sq. ft. Each is equipped with a microwave, two-plate burner, fridge colour TV and phone, as well having as a private bathroom. Weekly housekeeping and change of linen is provided. The rents begin at approximately $500 per month. Minimal parking is required, as the project is located close to downtown and public transit.

Vancouver SRO (Washington) The Housing Authority is developing a 124 unit SRO in a joint venture with Veterans Affairs. The property will provide a mix of 88 small studios (160 sq. ft) and 36 one-bedroom (240 sq. ft) units with rents averaging $327. The project is heavily subsidized with tax credit equity and soft second mortgage financing. Veteran's Affairs have provided the land on a long-term lease but capital and soft costs remain high at $48,000 per unit. Based on other SRO accommodations operated by the housing authority, maintenance costs are budgeted 30% higher than conventional low-income apartment development. As well, administration costs are higher due in part to 24-hour staffing. The client clientele are 50% veterans and 50% other with various community service providers referring tenants.

The Baltic Inn, San Diego (From Quigley, 1996)





Richmond, Virginia motel conversion (Although not new construction, this example illustrates a relatively cost effective conversion of a fairly typical building form - and one quite prevalent on the periphery of Ontario cities e.g. Kingston Road in Scarborough)

The Richmond Housing Authority has undertaken two rehabilitation projects in order to provide affordable housing in response to homelessness. One project involved the rehabilitation of an existing vacant motel (former Econo-lodge). The structure was a two storey wood frame building with an interior central corridor. The retrofit involved adding a small kitchenette as the units already had a full bathroom.
The project was facilitated under the Section 8 moderate rehabilitation program.

The Heights, New York City. The Heights is a rehabilitation of an existing 20 unit abandoned apartment building to create 55 new SRO rooms that are more typical of the traditional older rooming house designs. The project is operated as a private non-profit and houses former homeless individuals. It is financed with a combination of tax bond financing and low-income Housing Tax credit equity as well as grants and loans from the city and foundations. The unit configuration involved 12 rooms on each four floors (2 through 5). Each room is 120 sq. feet - essentially just a bedroom. No sinks are provided in the rooms, as the plumbing costs would have caused the cost to exceed the Section 8 moderate rehabilitation guideline. Instead each floor has three complete baths, a kitchenette and a lounge. The rehabilitation cost was $20,000 per unit and tenants pay one third of tenant incomes - rents range from $96-$217. (Frank, 1991, p 256)

Canadian experience

Following the lead from the U.S. there has been similar interest in Canada in adopting lower cost building forms. Through the mid 1980s and early 1990's a number of projects with smaller scale "efficiency units" were developed under social housing programs. These typically involve self-contained units built to a minimal suite size under prevailing code allowance (generally 275 to 300 sq. ft). Notably there is one very recent example of a market rent SRO developed in Vancouver - although not developed under a social housing program the project does benefit from some public assistance in the form of leased land and below market interest rates (through a BC interest reduction program).

In addition, there are a number of very recent proposals to develop unsubsidized

projects in major Canadian cities, including projects in Victoria, Vancouver and Toronto.

600 Drake St Mini Suite Project, Vancouver. This project was privately developed by Greystone developments (a company created jointly by the City of Vancouver and a number of pension funds with the city providing land on a leased basis with deferred profit sharing - effectively meaning no capital cost for land). Located adjacent to the downtown core and False Creek, it is a masonry high-rise providing 191 units. Most are studio bachelors of 275 sq. ft (there are six 1-bedroom units of 595 sq. ft). Rents range from approximately $500 (smaller bachelors) to $1,000 (1 bedroom). Suites are self-contained with private bathrooms and kitchenettes. Common space is limited to a recreation space with large screen TV (and windows to laundry area). A total of 141 underground parking were required (effectively a ratio of 0.73).

VanCity Place for Youth (1998)
A 45 unit small suite project - developed as a joint venture between VanCity Enterprises and the City of Vancouver specifically for street youth - the property was occupied in late 1998. Units range from 275 sq. ft-325 sq. ft with corresponding monthly rents from $325-$425. The city provided land and a capital grant, while VanCity also providing a grant of $1million and providing financing for remainder of the debt. The building is 4-storey wood-frame construction with commercial space on the main floor. Each suite is provided with bathroom and kitchenette. A resident manager lives onsite.

Cool Aid Mini Suite Project, Victoria (in process)
The Cool Aid Housing Society is seeking to develop a mini-suite apartment targeted to young singles and street youth in Victoria. The objective is to develop an economically viable project with no ongoing subsidy, affordable at basic welfare shelter allowance or low-wage. The property adjoins a city parkade and another Cool Aid Society project where tenants can access social and recreational space. The units are 182 sq. feet plus a 100 sq. ft loft providing a sleeping area (with 4'-6" headroom). The building will be four-storey wood-frame with 40 mini-suites and 6 one-bedroom units. The city has exempted the property from parking requirements, which has a very significant impact on the economic feasibility.

Affordable Housing Society Vancouver is currently developing an apartment property for singles in the down town area. The project will include 136 suites of 340 sq. feet. The units are fully self contained, including a bathtub. A suite size of 300 sq. ft was determined to be a minimal size to accommodate a fully self contained unit (and this

meets current zoning and building regulations with respect to minimum suite size) however design consideration enabled the size to be increased to 340 sq. feet.

30 St Lawrence, Toronto

Dixon Neighbourhood House (DNH), a non-profit organization is undertaking the development of 10 four-bedroom new construction townhouses, which will provide permanent housing for 40 formerly homeless men and women. This housing will be owned and managed by DNH with Dixon Hall providing support services. Each town house will provide 4 separate private rooms together with common kitchen, living and bathroom facilities. Each town house will have a total area of 1500 sq. feet (check size of individual rooms). Tenants will pay the basic welfare shelter maximum of $325 (1300 per unit). The city has donated the land and provided a capital grant of $400,000. This significantly reduces the level of project financing required and the associated debt servicing costs such that the project is viable based on the $325 monthly rent level.

Barnett proposal "Student Residence" Toronto

A Toronto Architect has developed a proposal to develop a property based on a student residence. Somewhat different from a SRO, this involved a number of shared units - each providing six private rooms (110 sq. ft) with space for a small bar size fridge. A communal kitchen and living room as well as two shared bathrooms complete the "shared living unit". At the building level, a common lobby, meeting space, office and laundry would be included. The total number of 6 room units depends on the site, but the proposal suggests a development in the region of 100 units with rents established at the welfare basic shelter maximum of $325.

Appendixes B: Schematic Floor Plans for Prototype Sites.

Schematic floor plans (ground floor and typical upper floors) for the two sites used in the costing analysis in Part 2.

The following Table summarizes the results of various configurations used to determine the optimal mix of units.

Exploration of net-gross efficiencies with differing unit and property sizes						
	Site 1			Site 2		
	10,800 sq. ft site (100' x 109') No elevator, surface parking for 6 cars			20,944 sq. ft, (200'x 101') One elevator, surface parking 10 cars		
Unit Size	175 sq. ft	210 sq. ft	250 sq. ft	175 sq. ft	210 sq. ft	250 sq. ft
Total Units	69	60	54	155	130	112
Net/Gross Efficiency	58.1%	61%	59.6%	62.8%	63.5%	64.8%

Traditional SRO model was also tested with unit size of 120 sq ft (approximately 10 x 12 feet) that include a lavatory but no kitchenette. Two common kitchens/dining rooms are provided on each floor, serving 25 rooms. With this configuration the net to gross efficiency is 53% when excluding kitchens from living area, or 62% when counting the shared kitchens/dining space as living area.

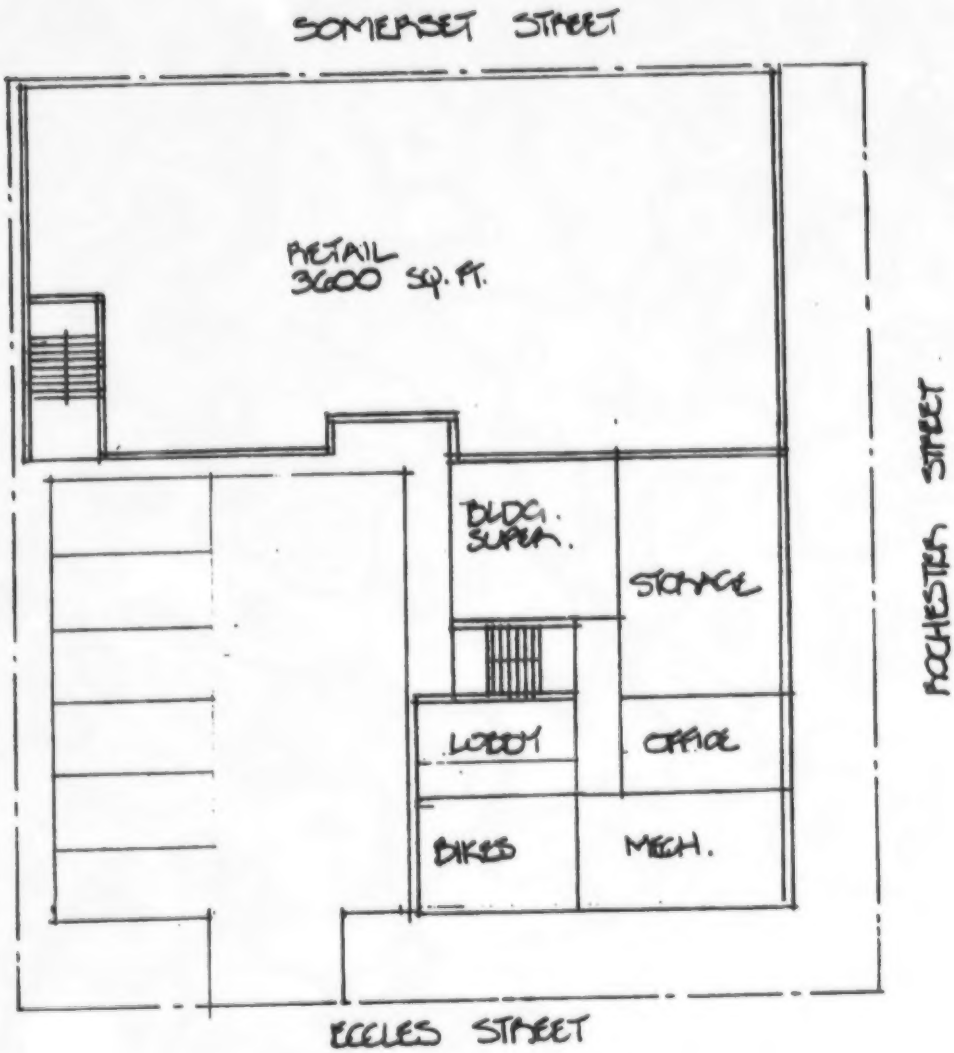
Plans for the following configurations are attached:

Site 1 (used as the "traditional SRO model"

- Ground Floor - includes administrative and mechanical space as well as 3,600 feet of commercial area.
- Typical Upper Floors with 120 sq.ft units
- Typical Upper Floors with 210 sq.ft units

Site 2 (used as the "market SRO model"

- Ground Floor - includes administrative and mechanical space as well as residential units
- Typical Upper Floors with 175 sq.ft units
- Typical Upper Floors with 210 sq.ft units



SITE AREA	10,822	SQ FT
BUILDING AREA	6,060	- (RETAIL 3600)
PARKING	2,160	(6 PLACES - 44 REQ'D - ZONING)
LANDSCAPED	2,600	

SITE 1.

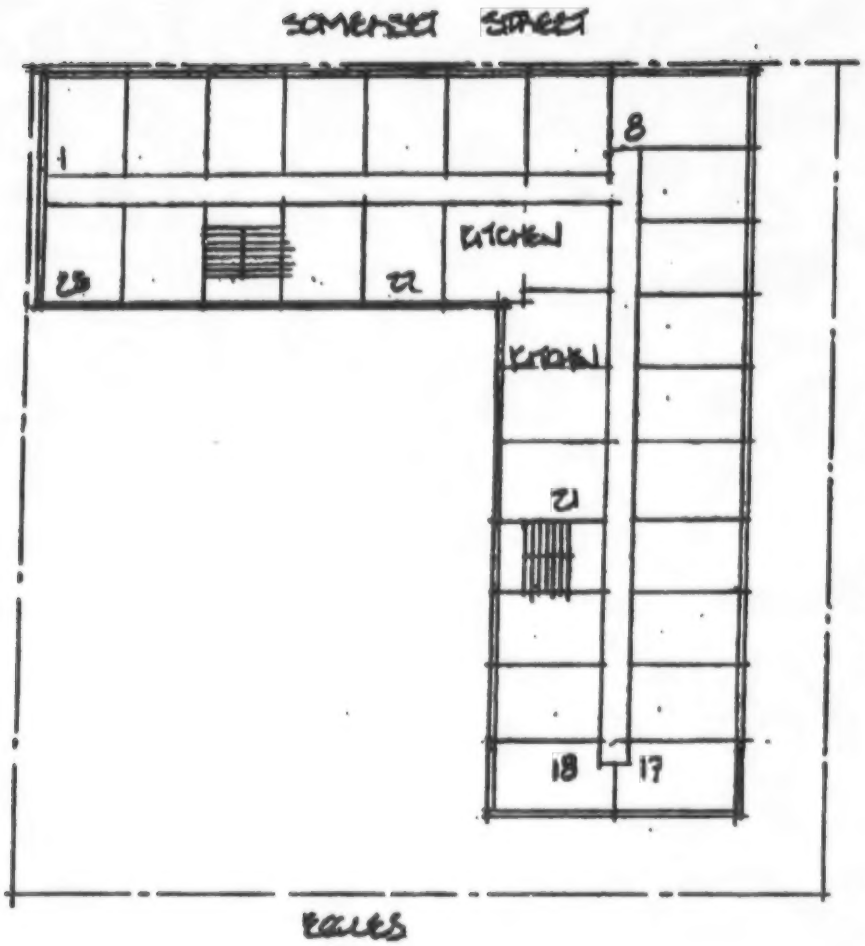
SOMERSET & ROCHESTER
GROUND FLOOR/BASEMENT

N

SCALE - 1"=20'

99/01/20

B-2



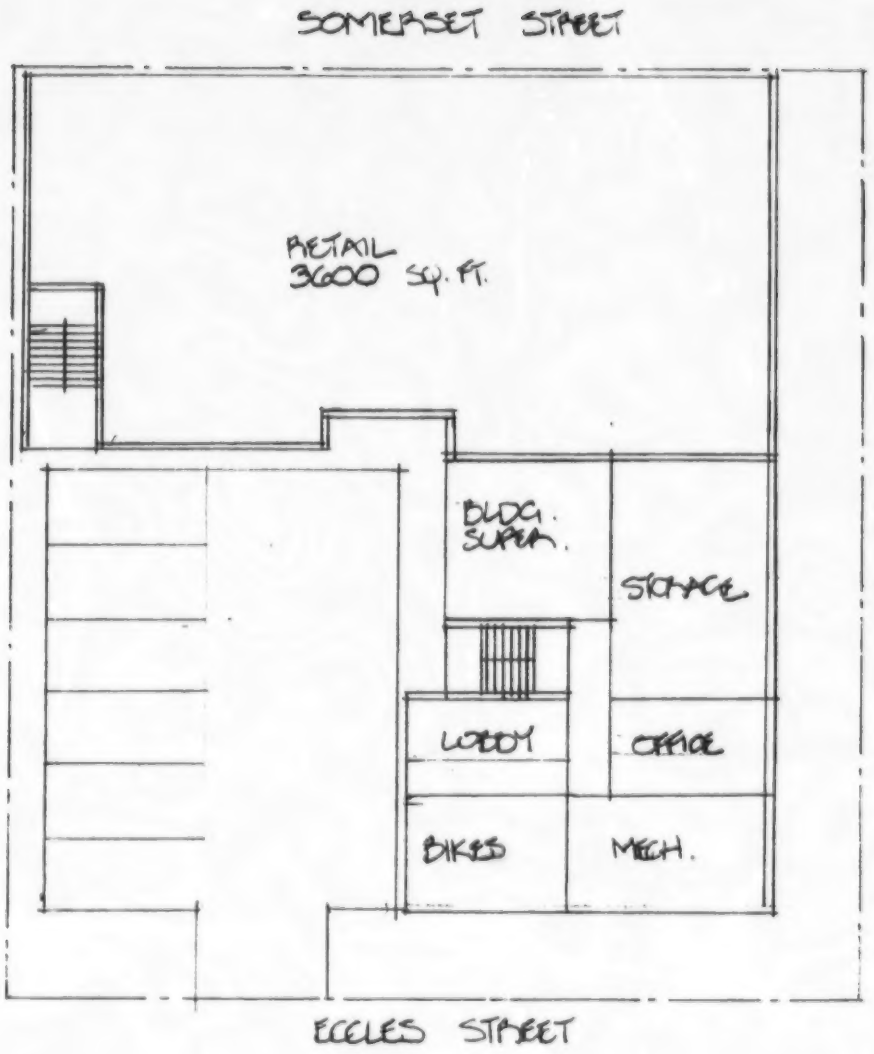
25 UNITS @ 120 SQ FT
2 KITCHEN/DINING @ 250 SQ. FT
12' CORRIDOR
BUILDING SIZE 4800 SQ FT

SOMERSET CHICHESTER

120 SQ FT UNITS
TYPICAL FLOOR

N

SCALE 1:120 30/01/26



SITE AREA	10,822 SQ FT	
BUILDING AREA	6,060	- (RETAIL 3600)
PARKING	2,160	(6 PLACES - 44 REQ'D - ZONING)
LANDSCAPED	2,600	

60 UNITS @ 210 SQ FT = 12,600
1 SUPER'T APT
RESIDENTIAL GFA 20,600
NET EFFICIENCY 61%

SITE 1

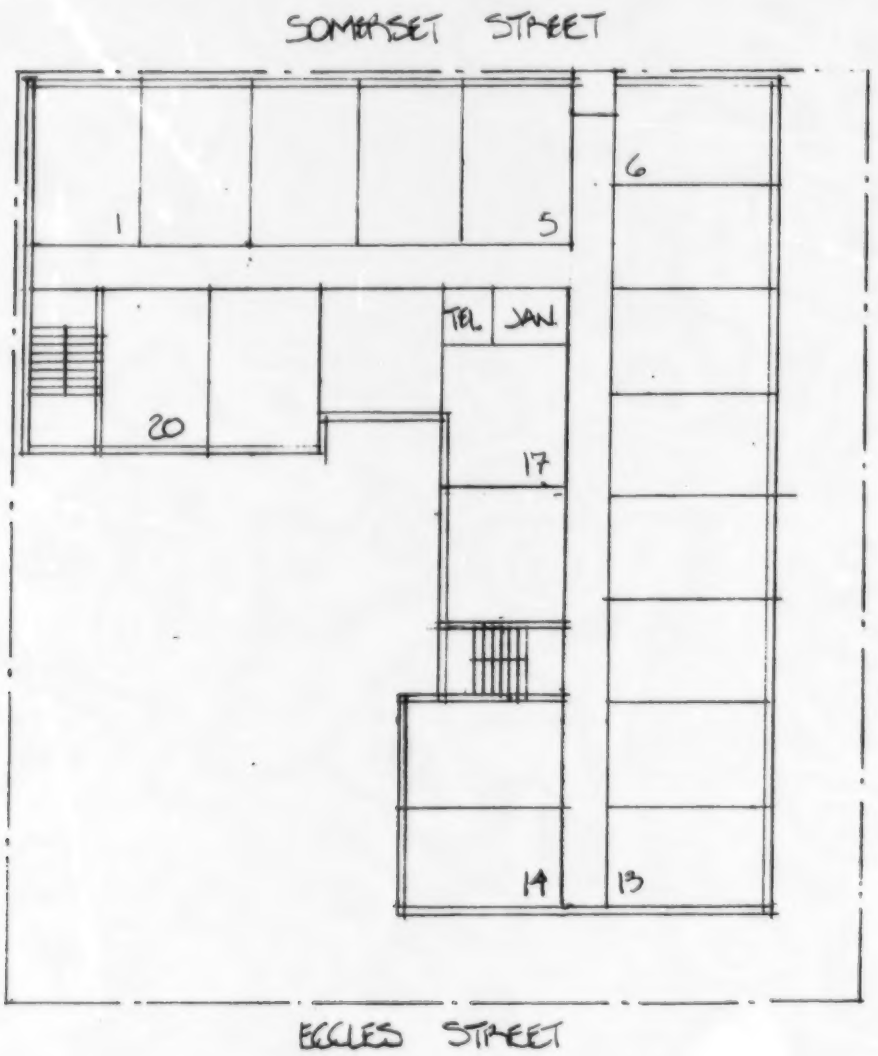
SOMERSET @ ROCHESTER

210 SQ FT UNITS
GROUND FLOOR/BASEMENT

N

SCALE - 1"=20' 99/01/20

B-4



NOTES : (SQ FT)

20 UNITS @ 210 SQ. FT - 4200
GFA 6060

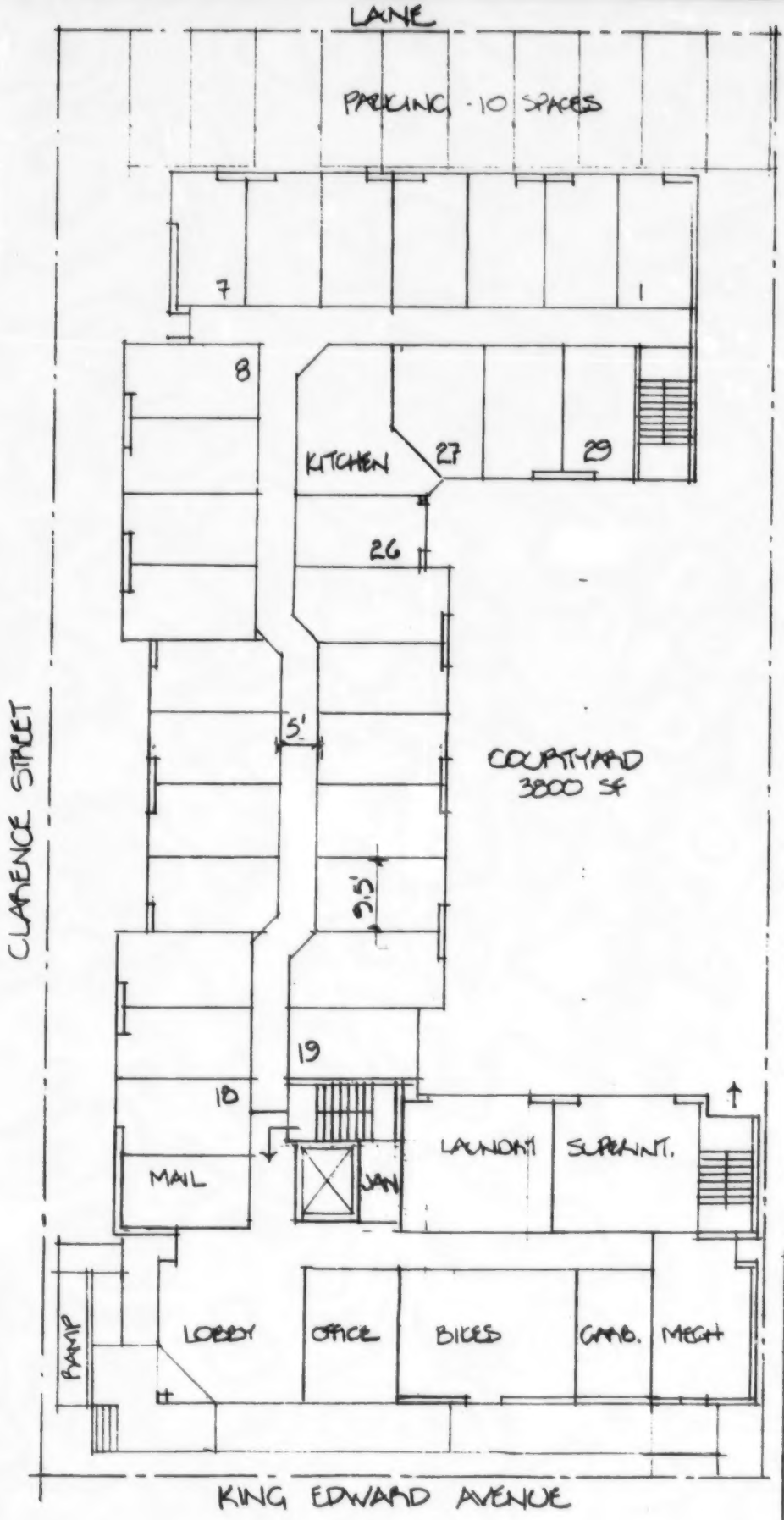
SITE 1

SOMERSET @ ROCHESTER

210 SQ. FT. UNITS
TYPICAL FLOOR

N.

SCALE - 1"=20' 99/01/20



NOTES (SQ FT)

29 UNITS @ 175 COMMON SPACE - 1800
GFA 10,800

ALL FLOORS
155 UNITS @ 175 = 27,125
GFA 43,200
NET EFFICIENCY 63%

SITE AREA 20,944
BUILDING AREA 10,800 *
PARKING 1,600
LANDSCAPED - 8544
INDOOR AMENITY 2400
TOTAL AMENITY 10,944
(REQ'D ZONING - 10,600)

*10,800 SQ.FT MAX. AREA (OBC) FOR 3 STOREYS (+ BASEMENT) WOOD FRAME, NOT SPRINKLERED.

GROUND FLOOR @ 30" +/- BELOW GRADE - CONSIDERED BASEMENT (OBC)

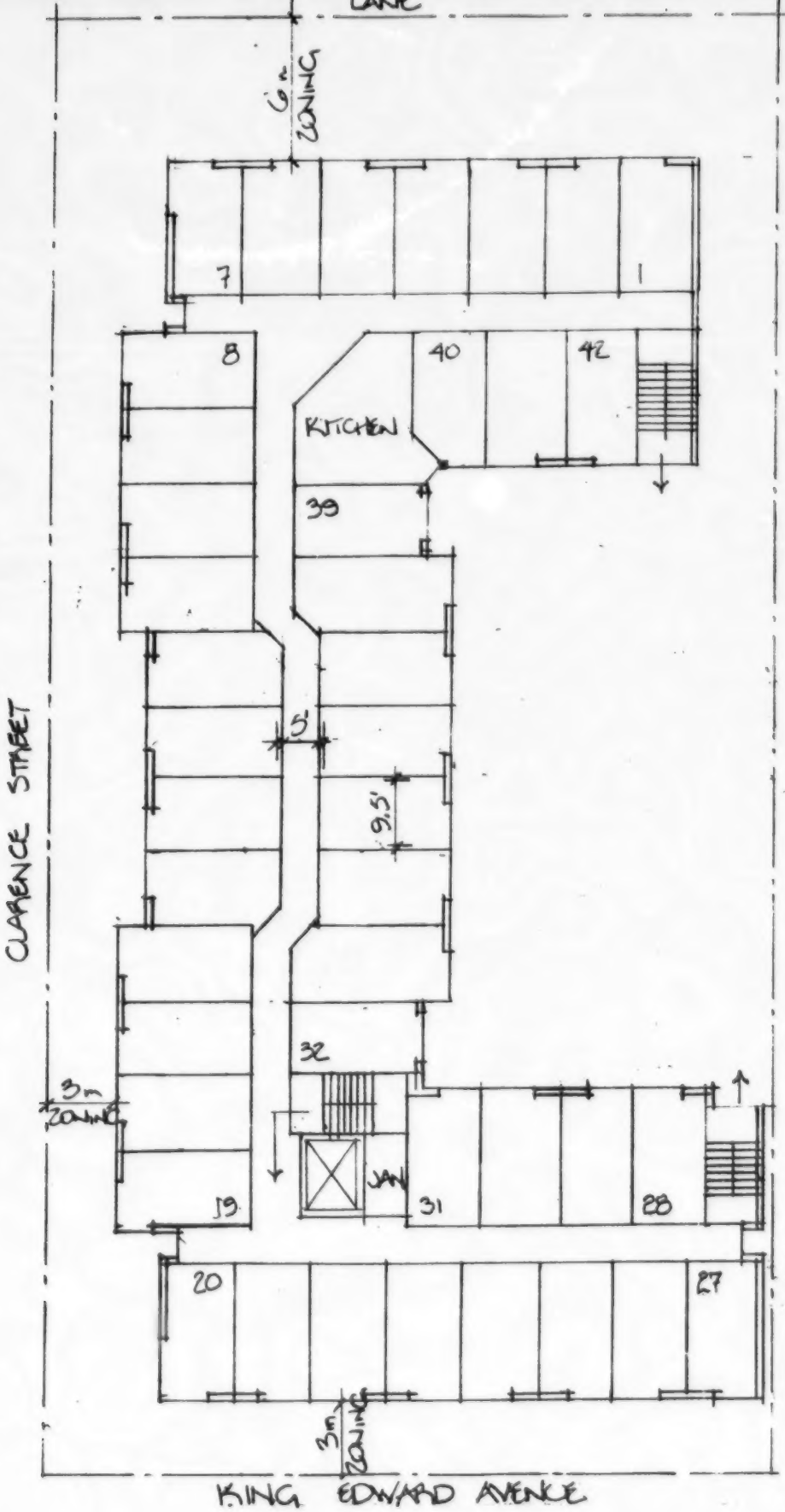
ADDITIONAL STORAGE IN SUB-BASEMENT

KING EDWARD @ CLARENCE

175 SQ.FT. UNITS
GROUND FLOOR/BASEMENT

N

SCALE 1" = 20' 95/01/20



NOTES (SQ. FT.)

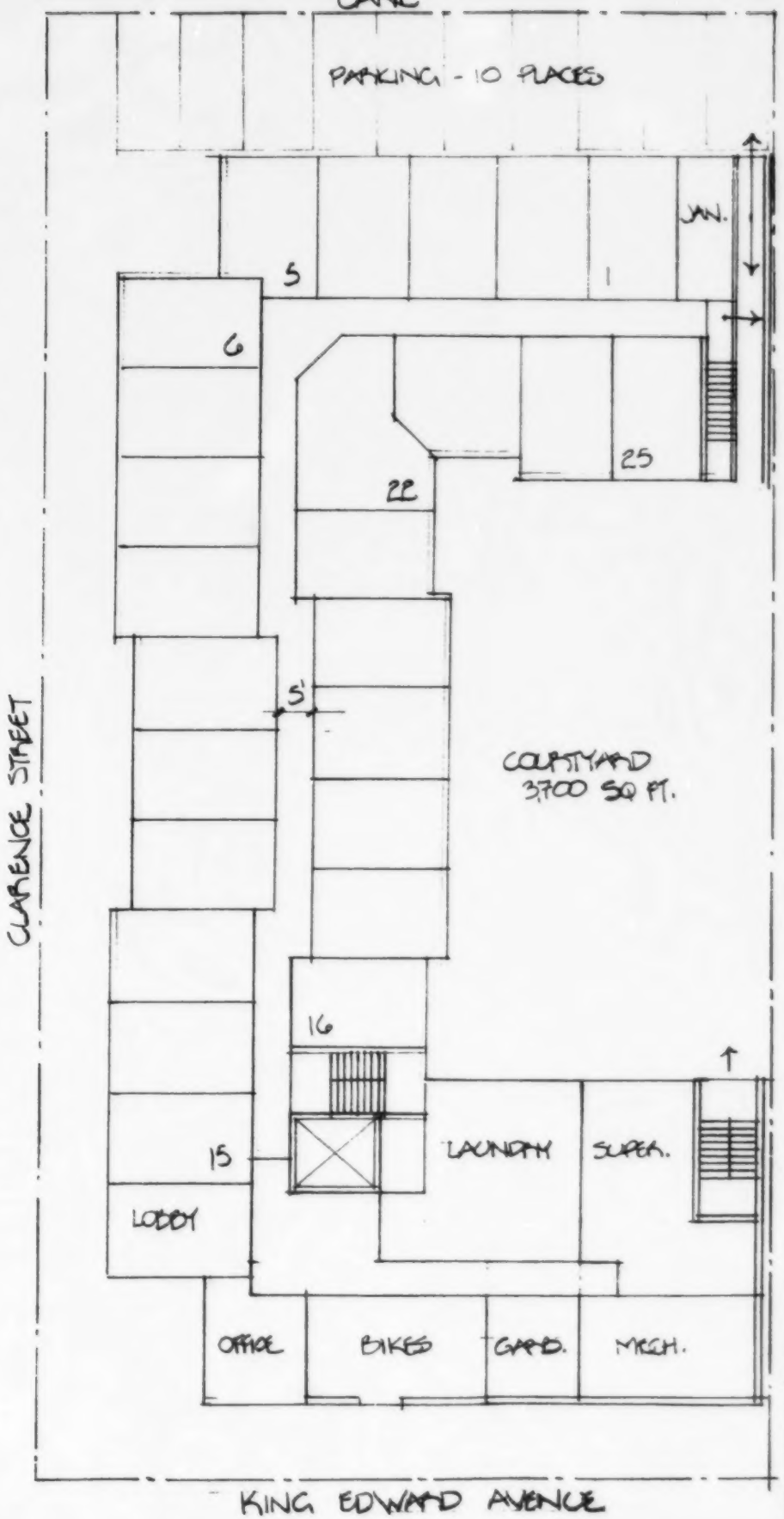
42 UNITS/FLOOR
@ 175 SF
TOTAL 7350
GFA 10,800

KING EDWARD & CLARENCE

175 SQ FT UNITS
TYPICAL FLOOR x 3

N

SCALE 1"=20' 90/01/30



NOTES: (SQ FT)
25 UNITS @ 210
COMMON SPACE - 1870
GFA 10,580

ALL FLOORS
130 UNITS @ 210
= 27,300
GFA 42,980
NET EFFICIENCY - 64%

SITE AREA	20,944
BUILDING	10,800 *
PARKING	1,600
LANDSCAPED	8,544
INDOOR AMENITY	2,836
TOTAL AMENITY	11,380
	(10,580 PER ZONING)

PARKING - 10 PLACES
(75 PER ZONING)

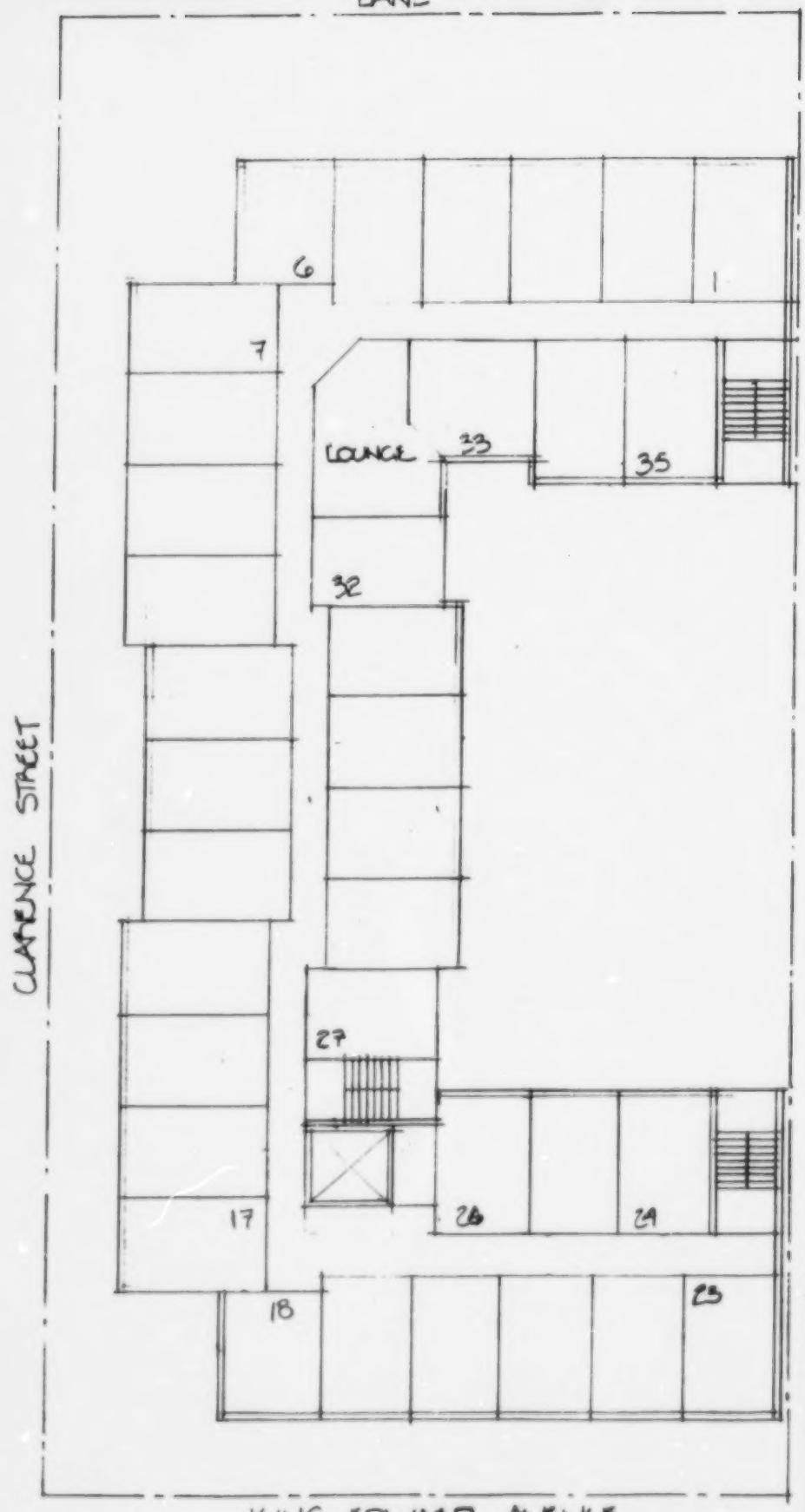
* 10,800 SQ FT - MAX. AREA (OBC) FOR 3 STOREY (+ BASEMENT) WOOD FRAME, NOT SPRINKLERED

GROUND FLOOR @ 30"+, BELOW GRADE - DEEMED BASEMENT (OBC)

ADDITIONAL STORAGE IN PARTIAL SUB-BASEMENT

KING EDWARD @ CLARENCE
210 SQ FT UNITS
GROUND FLOOR/BASEMENT

SCALE - 1"=20' 99/01/20



NOTES (SQ. FT.)
35 UNITS @ 210
TOTAL 7350
GFA 10,800

KING EDWARD @ CLARENCE
210 SQ FT UNITS
TYPICAL FLOOR x 3

N

SCALE 1:120' 99/04/20